

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: De La Torre Analyst: Jahna Alvarado Bill Number: AB 1955
See Legislative
Related Bills: History Telephone: 845-5683 Amended Date: August 10, 2010
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Additional Tax On Gross Income Of City Council Of Excess Compensation City

SUMMARY

This bill would impose an additional 50 percent tax on a qualified taxpayer's excess gross income derived from a designated excess compensation city.

This bill also would make changes to the Government Code and the Health and Safety Code. The discussion of these changes is limited to the changes that would impact the Department.

SUMMARY OF AMENDMENTS

The August 10, 2010, amendments removed all of the bill's provisions, which related to public officers and employees, and replaced them with the provisions discussed in this analysis.

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

PURPOSE OF THE BILL

It appears that the purpose of this bill is to impose an additional tax on amounts in excess of the amount specified in existing law that is paid by a designated excess compensation city to its city council members.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2011.

POSITION

Pending.

Summary of Suggested Amendments

Amendment 1 is provided to clarify the department's administration of this bill and includes suggested appropriation language to fund the department's costs to implement the provisions of this bill.

Board Position:

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Department Director

Date

Selvi Stanislaus

08/19/10

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

All California cities are municipal corporations. Their formation is provided for in the state constitution, and they fall into three categories: general law cities, charter cities, and one consolidated city and county (San Francisco).

General law cities derive their powers from and organize their governments according to acts of the legislature. The fundamental law of these cities is found in the state Government Code, which enumerates their powers and specifies their structure. Charter cities are formed when citizens specifically frame and adopt a charter or document to establish the organization and basic law of the city. The constitution guarantees to these charter cities a large measure of "home rule," granting to them, independent of the legislature, direct control over local affairs.¹

Under current state law², general law cities set the compensation paid to the city's council members as follows:

1. The amount enacted by ordinance and based on the population of the city, as follows:
 - For cities up to and including 35,000 in population, up to and including three hundred dollars (\$300) per month.
 - For cities over 35,000 up to and including 50,000 in population, up to and including four hundred dollars (\$400) per month.
 - For cities over 50,000 up to and including 75,000 in population, up to and including five hundred dollars (\$500) per month.
 - For cities over 75,000 up to and including 150,000 in population, up to and including six hundred dollars (\$600) per month.
 - For cities over 150,000 up to and including 250,000 in population, up to and including eight hundred dollars (\$800) per month.
 - For cities over 250,000 population, up to and including one thousand dollars (\$1,000) per month.

Increases to these amounts are allowed up to a maximum of 5 percent for each calendar year since the last increase went into effect.

OR

2. The amount approved by a majority of the voters in the city.

¹ <http://www.smartvoter.org/gtg/ca/state/overview/municipal.html#3>

² Government Code section 36516.

State law provides that an additional compensation amount may be set for services as the mayor of a general law city and for services as a member of a board or similar body. The mayor's compensation may be set by ordinance or by the approval of the city's voters. The compensation for a board member's services may not exceed \$150 per month unless a greater amount is specifically allowed by statute.

State law prohibits automatic salary increases for members of a general law city's council members.

Amounts provided by a general law city to its council members for the following are excluded from the statutory limits:

- Retirement, health and welfare, and federal social security benefits if the city pays the same benefits for its employees; and
- Reimbursement of council members' actual and necessary expenses.

The California Constitution allows cities to adopt local charters with majority-voter approval. The Constitution allows charter cities to control their own municipal affairs. Relying on the municipal affairs doctrine, the 119 charter cities can set their city council members' compensation without regard to the statutory limits provided in Government Code section 36516.

THIS BILL

This bill would, under the Personal Income Tax Law, for taxable years beginning on or after January 1, 2011, establish an additional 50 percent tax on the gross income that is derived from a designated "excess compensation city," as defined, to a qualified taxpayer, as defined, that is in excess of the amounts specified in Government Code section 36516, as previously discussed.

An "excess compensation city" would be defined as a city that has been determined to be an excess compensation city by the Attorney General (AG). Because gross income in excess of the amount as specified could be paid by either a charter city or a general law city to a qualified taxpayer, as defined, an excess compensation city could be either a general law city or a charter city. A charter city that, under the terms of the city's charter, requires the city council members to devote their entire time to duties related to their office would be excluded from the definition of an excess compensation city.

A "qualified taxpayer" would be defined as a member of a city council of an excess compensation city.

The AG would be responsible for making the determination that a city is an excess compensation city, and would be required to both notify the city's council in writing of the determination and provide the city the option for a hearing to demonstrate that the city is not an excess compensation city. In the event that the AG's determination stands, the AG would be required to notify the city, the Franchise Tax Board (FTB), and the city's redevelopment agency of the final determination.

A city that has been determined to be an excess compensation city may, upon becoming compliant with Government Code section 36516, submit to the AG a written request for revocation of the excess compensation city status. If applicable, the AG would be required to immediately notify the FTB and the city's redevelopment agency in writing of the revocation.

The additional tax would be calculated without regard to credits, deductions, filing status, and recomputation of income tax brackets.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill is silent on a number of administrative details with regard to the AG's determination that a city is an excess compensation city. For example, would all of California's cities be subject to the review process? When and how often would the review process occur? When would notification of an excess compensation city determination be required to be communicated to the department? For purposes of notifying the department of a revocation of excess compensation city status, what does "immediately" mean? It is recommended that this bill be amended to clearly and consistently express the author's intent.

This bill uses the undefined phrase, "gross income derived from" an excess compensation city. The absence of a definition to clarify this phrase could lead to disputes with taxpayers and would complicate the administration of this additional tax. For example, because "gross income derived from" a city could be interpreted to include payments received on all transactions between a council member and the city, i.e. a sale of property by the member to the city, the additional tax would apply to the gross income from such a sale. If it is the author's intent that the additional tax would be limited to excess compensation for services rendered as a city council member, this bill should be amended.

The additional tax would apply to individuals that are members of a city council of an excess compensation city. It is unclear whether or in what circumstances the additional tax would apply to income received by a former city council member subsequent to that member's term of office. The author may wish to amend this bill for clarity.

Because “qualified taxpayer” would be defined as a member of a city council of an excess compensation city, the additional tax that this bill would create would be inapplicable to city officials or employees that may receive gross income in excess of the specified limit, e.g., the city manager or police chief. If it is the author’s intent that all individuals employed by a designated excess compensation city that receive gross income from the designated city in excess of the specified limit would be subject to the additional tax, this bill should be amended.

This bill is silent on a reporting method that would identify qualified taxpayers that would be subject to the additional tax. As a result, because the department would be reliant on self-reporting, a qualified taxpayer that did not self-report or that failed to file a state income tax return may go unidentified. The author may wish to amend this bill to provide for the identification and reporting to the department of city council members that become subject to the additional tax.

The bill is silent on the timing of payments that would be subject to the additional tax. For example, would all payments received on or after the date of the AG’s determination be subject to the additional tax? All payments received during the taxable year that the determination is made? Would deferred income earned prior to a city’s designation as an excess compensation city and paid to a qualified taxpayer after designation as an excess compensation city be subject to the additional tax? Lack of clarity could lead to disputes between taxpayers and the department and would complicate the administration of this tax.

Because this bill is silent on the applicability of administrative provisions such as penalties, interest, and the method and process of assessing this new tax, it is unclear how the additional tax would be treated. For example, would penalties apply, (i.e. the estimate payment and understatement penalties). Amendment 1 includes suggested language that would clarify how the administrative provisions of the income tax law would apply to the new tax that this bill would create.

This bill is silent on how an individual would be informed that (1) the city would be designated an “excess compensation city” and (2) the individual had received excess compensation from the city that would be subject to the additional tax. As a result, penalties could be assessed against an individual that is unaware of the additional tax liability. The author may wish to consider amending this bill to require excess compensation cities to report excess compensation information to affected individuals.

This bill is silent on a mechanism that would allow affected individuals to avoid the application of this tax by refusing or returning the excess compensation amount. The author may wish to consider amending the bill to provide such a mechanism.

LEGISLATIVE HISTORY

No similar legislation was identified.

OTHER STATES’ INFORMATION

No similar laws were identified.

FISCAL IMPACT

Staff estimates a one-time cost of approximately \$219,000 to develop, program, and test revisions to existing systems for this bill. Due to the current fiscal environment and the need for increased resources necessary to implement other pending bills, implementation of this bill is contingent on funding. Accordingly, suggested language is provided in Amendment 1 to fund the department’s implementation costs for this bill. If this bill is enacted without appropriation language, the department will pursue a budget augmentation (“legislative budget change proposal”) through the normal budgetary processes, which would delay implementation of the bill’s provisions to July 1, 2011. If approval of a legislative budget change proposal is denied, the department may be unable to implement the provisions of this bill.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this bill would be:

Estimated Revenue Impact of AB 1955 As Amended August 10, 2010 Effective For Taxable Years Beginning On Or After January 1, 2011 Enactment Assumed By September 30, 2010 (\$ in Millions)		
2010-11	2011-12	2012-13
\$0.7	\$1.0	\$0.6

This estimate assumes that ten cities are found to be paying excess compensation in 2011, six in 2012 and four in 2013.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this measure.

ARGUMENTS/POLICY CONCERNS

Because state income taxes may be reported as a deduction on the federal tax return, the additional tax authorized by this bill would be eligible as a federal deduction.

LEGISLATIVE STAFF CONTACT

Legislative Analyst

Jahna Alvarado

(916) 845-5683

jahna.alvarado@ftb.ca.gov

Revenue Manager

Monica Trefz

(916) 845-4002

monica.trefz@ftb.ca.gov

Asst. Legislative Director

Patrice Gau-Johnson

(916) 845-5521

patrice.gau-johnson@ftb.ca.gov

Analyst	Jahna Alvarado
Telephone #	(916) 845-5683
Attorney	Pat Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1955
AS AMENDED AUGUST 10, 2010

AMENDMENT 1

On page 7, between line 28 and 29, insert:

(d) For purposes of applying Part 10.2 (commencing with Section 18401) of Division 2, the tax imposed under this section shall be treated as if imposed under Section 17041.

SEC. 5.5. The sum of two hundred and nineteen thousand dollars (\$219,000) is hereby appropriated to the Franchise Tax Board in augmentation of its support budget.