Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Evans	Analyst:	Jahna Alvarado	Bill Number:	AB 2113
Related Bills:	See Legislative History	Telephone:	845-5683	Introduced Date:	February 18, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Local Personal Income Tax

SUMMARY

This bill would authorize the board of supervisors of any county, or city and county (hereinafter "county"), to place on a ballot by ordinance, subject to voter approval, either provisions to impose a local personal income tax (LPIT) to be assessed and collected by the Franchise Tax Board (FTB) or provisions to impose a vehicle license fee (VLF) administered by the Department of Motor Vehicles (DMV), or both.

This bill would also authorize wage withholding by the Employment Development Department (EDD) for the LPIT.

This bill would make changes to laws affecting the DMV and the EDD. To the extent that these changes do not affect the FTB, they are not discussed in this analysis.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide local control over the quality of services provided by local government by giving the county a mechanism to increase operating revenues with the consent of its residents.

EFFECTIVE/OPERATIVE DATE

If enacted by September 30, 2010, this bill would be effective January 1, 2011, and as specified by its terms, would be operative for purposes of the LPIT for taxable years beginning on January 1 of the calendar year following voter approval, conditioned on the county elections officials providing notice by September 30 of the preceding year of the passage of the ordinance.

POSITION

Pending.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Selvi Stanislaus	04/23/10
_______ N	_______ OUA	___X___ PENDING		

ANALYSIS

FEDERAL/STATE LAW

Current state law imposes a VLF on its residents for the privilege of operating a vehicle on public highways. Beginning May 19, 2009, and until July 1, 2013, the fee is calculated at 1.15 percent of the market value of a vehicle and is assessed annually. Counties currently receive an allocation from the General Fund that represents the difference between the current VLF rate and the rate that was in place in 2003, when the Governor rolled back the VLF rate statewide.

Existing federal and state law allows individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and certain state or local taxes paid as itemized deductions. The VLF imposed by a state or local entity is considered a personal property tax that can be deductible for individuals as a personal property tax on the federal Schedule A for itemized deductions. For business entities, the VLF can be deducted as a business expense for vehicles used in the business.

Existing state law imposes tax on the income earned by individuals, estates, trusts, and certain business entities. Tax is imposed on the entire taxable income of residents of California and upon the taxable income of nonresidents derived from sources within California. The tax for individuals is computed on a graduated scale at rates ranging from 1.25 percent to 9.55 percent. State income tax law specifically prohibits local governments from levying or collecting a tax on an individual's income.[1]

On an annual basis, the FTB is required to provide the EDD with wage withholding tables to be used by employers to withhold taxes on wages paid to their employees. The tables are based on the estimated amount of tax due on the wages paid by the employer. Taxpayers are required to make estimated tax payments if the amount of taxes withheld or otherwise available for a taxable year is less than the amount due.

Current state law authorizes the FTB to use administrative collection tools to collect delinquent tax and non-tax debt liabilities, and specifies the order that payments will be applied ("priority of payments") in situations where the FTB is taking collection action against a debtor for more than one type of debt.

Under the California Constitution, taxes imposed by local governments are deemed to be either general taxes or special taxes. "General tax" means any tax imposed for general governmental purposes. "Special tax" means any tax imposed for specific purposes. Local government is prohibited from imposing, extending, or increasing any general tax unless and until that tax is submitted to the electorate and approved by a majority vote.[2] Special taxes must be approved by two-thirds of the electorate.[3]

---

[1] Revenue and Taxation Code section 17041.5
[2] California Constitution, article XIII C, section 2 (c)
[3] California Constitution, article XIII C, section 2(d)

THIS BILL

In addition to any other tax authority granted under law, this bill would authorize the board of supervisors of any county to, by ordinance, place on a ballot either or both of the following:

- An LPIT on county residents that would be administered by the FTB.
- A local license fee on any vehicle of a type that is subject to registration under the Vehicle Code.

The bill would authorize the LPIT with the following provisions:

- The bill would allow an additional tax to be imposed on the tax liability after reduction for personal exemption credits of a county resident at the rate approved by the voters of that county. The tax imposed by this bill would be treated as though it were imposed under the same statutes as a state income tax.

- The term "resident" would be defined as any individual who lives or is located in a county on more than a temporary or transient basis.

- This bill would require a taxpayer that resides in more than one county to pay a proportionate share of the LPIT liability to each county based on the percentage of time that the taxpayer resides in each county.

- This bill would require the FTB to develop and provide wage withholding tables for the LPIT to the EDD, as specified.

- This bill would disallow the following:

    - The LPIT from being used to reduce the PIT,
    - PIT credits from being used to reduce the LPIT, and
    - A county from allowing a credit or deduction against the LPIT.

- The bill would require the county to enter into agreements with the FTB and the EDD to perform all functions incident to their administration of the LPIT, which includes a provision that the county would reimburse the FTB for all refunds, losses, and costs incurred in the administration and operation of the LPIT.

- The bill would provide that a local ordinance authorized to impose an LPIT would become operative for taxable years beginning on or after January 1 of the first calendar year following approval by the voters of the county if the county elections official provides notice of the voter approval no later than September 30 of the preceding calendar year of the passage of the ordinance by voters.

- The bill would authorize the FTB to use any information sources or enforcement remedies available to the county in addition to the information sources and remedies available to the FTB for administering the state income tax.

- The bill would provide that payments and credits would be applied first to the PIT liability and then to the LPIT liability.

- The bill would authorize, when requested by resolution of a county's Board of Supervisors, the FTB to permit a county's designee to examine the FTB's PIT records related to the county's LPIT.

- The bill would authorize the FTB to adopt regulations as necessary to administer its provisions and would exempt these regulations from the Administrative Procedures Act rulemaking requirements.

- The bill would provide that amounts collected under its provisions are to be transmitted to the Treasury and deposited to the credit of the Local Personal Income Tax Account (Account) in the General Fund that would be created under the bill's provisions. The moneys in the Account would be continuously appropriated, regardless of fiscal year, to the Controller for allocation to each county that enacts the tax.

This bill would allow the local VLF as a deduction for state income tax purposes.

IMPLEMENTATION CONSIDERATIONS

Department staff have identified the following implementation considerations for purposes of a high-level discussion. Additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill would make the operative date of the bill for taxable years beginning on or after January 1 of the first calendar year following approval by the voters, conditioned on the county elections official providing notice no later than September 30 of the preceding year. The bill is silent regarding who is to receive notice from the county. It is recommended that the author specify that notice of a voter approved county income tax would be required to be provided to the FTB.

The bill reimbursement structure would require the FTB to borrow funds from the General Fund programs it administers to implement and maintain the LPIT programs until the county can reimburse those amounts at a later date. The FTB lacks sufficient resources to fund the county program for any period without putting at risk the core mission of state income tax administration. It is recommended that, consistent with the process in place between the Board of Equalization and local entities for local sales tax administration, the amounts transferred to the county be a net amount of funds collected reduced by the amount of costs, refunds, adjustments, or losses incurred by the FTB in administering the county income tax.

Additionally, while the bill would provide reimbursement to the department for costs incurred to implement and maintain its provisions, recent budget adjustments have impacted the department's ability to perform the work necessary to implement this bill. Even with reimbursement, additional position authority would be necessary to implement the bill without adversely impacting the department's existing General Fund revenue generating workload priorities.

The bill would authorize, when requested by resolution of a county's Board of Supervisors, the FTB to permit a county's designee to examine the FTB's PIT records related to the county's LPIT, and would limit the use of this data to specific purposes. The bill is silent on the consequences of unauthorized use of this data. Revenue and Taxation Code (R&TC) section 19552 specifies that unauthorized use of data is a misdemeanor. It is recommended that this bill be amended to specifically state that this section would apply to FTB data related to the LPIT.

The bill specifies that payments and credits shown on the tax return shall be applied first to the state personal income tax, including interest and penalties, if any, and then to the LPIT. It is unclear what the priority of payment would be between the LPIT and other debts that the FTB is authorized to collect. Because R&TC section 19533 provides for the priority of debts owed, the author may wish to amend existing law to include the LPIT in the priority of payment structure to maintain consistency within the Code and to prevent disputes between taxpayers or counties, and the department in administering the provisions of this bill.

The bill would require the FTB to administer and collect the LPIT in the same manner as the PIT. It is unclear if the author intends for the PIT administrative provisions regarding penalties, fees, interest, assessment, audit, protest, and appeal to apply to the LPIT. The consequences are unclear for a taxpayer subject to a PIT audit that results in an adjustment of taxable income. Because the local income tax is a percentage of the tax liability for PIT purposes, clarification is needed if the FTB would recalculate the LPIT and send a notice to the taxpayer to reflect the recalculated LPIT amount.

Under the terms of this bill, a taxpayer that is a resident of more than one county during a taxable year would be required to allocate the LPIT among their counties of residence based on the percentage of time during the taxable year that the taxpayer resided in each county. Because of taxpayer mobility, this could result in increased taxpayer burden and confusion for taxpayers that relocate frequently, (e.g. relocations due to seasonal employment).

This bill would define a resident as an individual who lives or is located in a county on more than a temporary or transient basis. The term "temporary or transient basis" is undefined. The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of the LPIT. For example, would an individual that has their family home in one county, that works in and maintains living quarters in a second county be subject to the LPIT imposed by the two counties?

The FTB lacks the resources to identify taxpayers by county of residence and would need to rely on taxpayers self declaring their residency on their state income tax return. In cases where a taxpayer is subject to an LPIT and fails to file a state income tax return, the department lacks the data to identify the county of residence with certainty because most income data received by the department reflects the taxpayer's mailing address, which may not be in the same county as the taxpayer's county of residence. Calculating an estimated LPIT liability based on a taxpayer's "last known address" could result in inaccurate amounts being remitted to the affected counties.

Because not all counties would enact an LPIT immediately, the first county to enact the tax would incur the entire cost for implementation while counties that enact the tax at a later date would not be charged the startup costs paid by the earlier enacting county. To prevent disputes between the county and the Department, it is recommended that the author specify how costs should be allocated among the counties that enact an LPIT.

This bill could result in as many as 58 contracts between the FTB and a county imposing an LPIT, each with differing provisions. For example, one contract may contain a provision requiring the FTB to audit the LPIT for that county, while another contract may be silent on or specifically preclude FTB audits of the LPIT. To prevent disputes between taxpayers or counties, and the department, to prevent dissimilar treatment between counties enacting an LPIT, and to minimize the costs a county imposing an LPIT would be required to reimburse the FTB, the author may wish to amend the bill to specify the terms of the FTB's administration of an LPIT that would be required in all contracts for administration of an LPIT.

TECHNICAL CONSIDERATIONS

References to withholding incorrectly use "or" when the estimated withholding should include withholding for both the personal income tax and the LPIT. On page 8, line 35, and on page 9, line 40, strikeout "or" and insert "and."

This bill would require the FTB to transmit to the Treasurer for deposit into the Local Personal Income Tax Account, all the LPIT amounts collected. This is in conflict with R&TC section 19602 that requires amounts collected under the PITL, unless specifically excepted, to be credited to the Personal Income Tax Fund. The author may wish to amend R&TC section 19602 to prevent any disputes between taxpayers or counties, and the department in administering the provisions of this bill.

LEGISLATIVE HISTORY

AB 1342 (Evans, 2009/2010) would have authorized a county or city and county to impose an LPIT, a VLF, or both, as specified, on the residents of that county or city and county upon approval by the voters and would have required the FTB to administer each approved LPIT. The provisions of AB 1342 with regard to the LPIT are substantially similar to this bill. AB 1342 failed to pass out of the Assembly Committee on Revenue and Taxation.

SB 10 (Leno, 2009/2010) would require the FTB to report to the DMV the estimated revenue loss as a result of deductions taken by residents of any county that has passed a voter approved local vehicle assessment. This bill was introduced December 1, 2008, and is currently in the Senate Appropriations Committee.

AB 1590 (Leno, 2007/2008) would have required the FTB to provide an estimate of the revenue loss to the state as a result of deductions taken by residents of the City and County of San Francisco for a local assessment. This bill was held in the Senate Revenue and Taxation Committee.

AB 799 (Leno, 2005/2006) would have required the FTB to report the estimated amount of revenue loss to the state as a result of increased itemized deductions taken by residents of the County for a local VLF. This bill was vetoed by Governor Schwarzenegger. The full veto message can be found in Appendix A of this analysis.

AB 1208 (Yee, 2005/2006) would have imposed an additional VLF on the residents of Santa Clara County for the purpose of funding maintenance and improvement of roads. This fee would have been a flat fee per registered vehicle. This bill was vetoed by Governor Schwarzenegger. The full veto message can be found in Appendix A of this analysis.

AB 1187 (Leno, 2003/2004) would have permitted the City and County of San Francisco to impose, upon voter approval, a local vehicle license fee. AB 1187 failed passage out of the Assembly Appropriations Committee.

AB 1690 (Leno, 2003/2004) would have given the FTB the authority to administer and collect a local income tax approved by the voters. This bill had provisions regarding public safety finance agencies and property taxes. AB 1690 was held in the Senate Appropriations Committee.

ACA 40 (Mazzoni, 1995/1996) would have allowed school districts to adopt a surtax on personal income with the approval of a majority of the voters of the district voting on the issue. This bill failed passage in the Assembly Revenue and Taxation Committee.

AB 2001 (Eastin, 1993/1994) would have allowed county boards of education to levy a personal income surtax on individuals who are residents of the county. This bill failed passage in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

Review of *Illinois, Massachusetts, Michigan*, *Minnesota*, and *New York* laws found the following information regarding local income taxes:

New York- Yonkers and New York City impose a progressive income tax with returns handled by the Department of Taxation and Finance.

Michigan- 22 cities in Michigan impose a 1.0 percent to 2.60 percent income tax on residents and .50 percent to 1.30 percent tax on nonresidents with returns handled by the individual city.

Illinois, Massachusetts, and *Minnesota* do not impose a city income tax. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved but are anticipated to be significant. Fiscal impact will be developed as the bill moves through the legislative process.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this bill would be determined by the amount of additional VLF deducted on tax returns and the tax rates of taxpayers deriving a tax deduction benefit.

For purposes of this estimate, it is assumed that all counties would impose a VLF fee on July 1, 2012. Based on this assumption, the proposed local fee would be allowed as a deduction for tax year 2012. Therefore, fiscal year 2012/13 would be the first year of General Fund revenue losses. This bill is silent on the VLF percentage counties could impose on taxpayers. Assuming the additional assessment ranges from 1 percent to 10 percent, the revenue loss would range from the tens of millions to hundreds of millions of dollars annually.

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

ARGUMENTS/POLICY CONCERNS

This bill would provide inequitable treatment for certain classes of taxpayers. For example, the LPIT under this bill would not be levied against individual taxpayers who do not have a PIT filing requirement or businesses and corporations that reside or do business within the area of the LPIT, even though everyone within the area would realize the benefits resulting from the increased funding.

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

Appendix A

BILL NUMBER: AB 799
VETOED DATE: 09/22/2006

To the Members of the California State Assembly:

I am returning AB 799 without my signature.

Within hours of taking office in 2003, I signed an Executive Order to reverse the car tax increase. That action returned $4 billion to the people of California. Putting that money back into the hands of hard working Californians is one of the ways we have helped our economy grow over the last three years.

This measure would, in effect, reinstate the car tax for the people of San Francisco. In fact, if the vehicle license fee increase proposed by this bill were enacted, the people of San Francisco could pay more than twice the amount to register their vehicles than anyone else in the state.

As noted in my veto messages of prior years, I am not opposed to modest increases in fees if such increases are approved by the impacted voters and not addressed in a piecemeal fashion. Although this bill requires voter approval, it impacts only one county. In addition, the revenues generated by this bill would not be directed to projects related to vehicles but used to bolster the city’s general fund. This is an unfair burden to place solely on the shoulders of motorists.

Throughout the year, my administration worked with members of the legislature on a proposal that would have given all counties the authority to adopt, with voter approval, modest license fee add-ons to fund environmental and traffic mitigation programs. Unfortunately, those efforts were ultimately rejected. I encourage the Legislature to reconsider this decision when they return next year.

Sincerely,
Arnold Schwarzenegger

BILL NUMBER: AB 1208
VETOED DATE: 10/07/2005

To the Members of the California State Assembly:

I am returning Assembly Bill 1208 without my signature.

This bill seeks to impose a new $5 tax on all cars in Santa Clara County and does so without a two-thirds vote of the people. While the goal of the program to increase funds for transportation infrastructure is laudable and vitally needed. I do not believe these fees should continue to be added without the approval from the people upon whom the fee is imposed.

In this year's budget, I proposed the full funding of Proposition 42 for the first time since its passage in 2002. The additional $1.3billion from Proposition 42 is just a fraction of the funds needed to relieve California's congested freeways and improve our roadways. Finding new funds for California's fractured infrastructure is a top priority; however, this piecemeal approach that does not allow for a vote of the people is not the right way to accomplish the goal.

For these reasons, I cannot support this measure.

Sincerely,
Arnold Schwarzenegger