Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Committee on Budget	Analyst:	William Koch	Bill Number:	ABX4 17
Related Bills:	See Legislative History	Telephone:	845-4372	Amended Date:	July 23, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Estimated Tax Payments/Wage Withholding

SUMMARY

This bill would do the following:

Provision No. 1: Increase the withholding rate on wages, supplemental wages, stock options and bonus payments.

Provision No. 2: Modify estimated tax payment percentages.

SUMMARY OF AMENDMENTS

This bill as introduced July 2, 2009, expressed the intent of the Legislature to enact changes to the Budget Act of 2009.

The July 23, 2009, amendments removed the intent language and added the provisions discussed in this analysis.

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

PURPOSE OF THE BILL

It appears the purpose of this bill is to accelerate revenue and increase tax compliance to address the fiscal emergency declared by the Governor by proclamation on July 1, 2009.

EFFECTIVE/OPERATIVE DATE

As a special session bill, this bill would become effective on the 91st day after adjournment of the special session. The operative dates of these provisions vary and are addressed separately for each provision.

POSITION

Pending.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Selvi Stanislaus	08/17/09
_______ N	_______ OUA	___X___ PENDING		

ECONOMIC IMPACT – SUMMARY REVENUE TABLE (in Millions)

Estimated Revenue Impact of ABX4 17			
Assumed Enactment after 06/30/09			
($ in Millions)			
	2009-10	2010-11	2011-12
Provision 1: Withholding Rate Increase	$1,600	$1	$58
Provision 2: Estimated Tax Payments	$600	$19	$37
TOTAL	**$2,200**	**$20**	**$95**

PROVISION NO. 1: INCREASE WITHHOLDING RATE ON WAGES, SUPPLEMENTAL WAGES, STOCK OPTIONS AND BONUS PAYMENTS

EFFECTIVE/OPERATIVE DATE

As a special session bill, this provision would become effective on the 91st day after the close of the special session and would be specifically operative for wages, supplemental wages, stock options and bonus payments paid on or after November 1, 2009, or the effective date, whichever is later.

ANALYSIS

STATE LAW

On an annual basis, the Franchise Tax Board (FTB) is required to provide the Employment Development Department (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. In addition, employers required to withhold tax on supplemental wages can use a method that applies a fixed rate to the supplemental wage amount. This rate is 6 percent for supplemental wages other than stock options and bonus payments. The rate of withholding for stock options and bonus payments is 9.3 percent. 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.

THIS PROVISION

This provision would require FTB to prepare wage withholding tables that would equate to an amount that is 10 percent higher than the amounts estimated to be due on wages earned under current law for wages paid on or after November 1, 2009.

This provision would also increase the fixed rate of tax withheld from supplemental wages from 6 percent to 6.6 percent, and would increase the fixed rate withheld from stock options and bonus payments from 9.3 percent to 10.23 percent for amounts paid on or after November 1, 2009.

LEGISLATIVE HISTORY

ABX3 19 (Evans, 2009/2010) and SBX3 17 (Ducheny, 2009/2010), in addition to other unrelated provisions, contain provisions similar to this provision. ABX3 19 was approved by the Senate and Assembly on June 30, 2009, and July 1, 2009, respectively, but has yet to be enrolled and sent to the Governor. SBX3 17 was vetoed by the Governor on June 30, 2009. In his veto message, Governor Schwarzenegger stated, "I have been very clear that the Legislature must solve the entire deficit, must make the hard decisions now, and must not push the problem off to tomorrow. This bill and its companion measure, SBX3 16, do not meet any of those criteria."

ABX3 36 (Laird, 2007/2008) contained provisions similar to this provision. Governor Schwarzenegger vetoed this bill. In the veto message the Governor stated, "I am returning Assembly Bill X3 36 without my signature, as I cannot support taking more money away from the paychecks of hard working Californians to balance the state budget. While this year's budget does not permanently solve California's structural deficit, it solves this year's $15.2 billion dollar budget gap, does not take money out of people's paychecks or borrow from voter-approved local government or transportation funds."

AB 2065 (Oropeza, Stats. 2002, Ch. 488) authorized 9.3 percent withholding on stock options and bonus payments in lieu of the withholding tables or supplemental income withholding rates.

OTHER STATES' INFORMATION

The states of *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York* were surveyed due to their similarities to California's economy, business entity types, and tax laws. With the exception of *Florida*, which does not have a personal income tax, all of these states require withholding of tax on wages paid by employers to their employees. However, these states do not require withholding greater than the estimated amount of tax due.

FISCAL IMPACT

The department estimates implementing this provision would increase first-year tax return processing costs by approximately $110,000 and $70,000 annually thereafter.

ECONOMIC IMPACT

Revenue Estimate:

Based on data and assumptions discussed below, this provision would result in the following annual revenue gains beginning in fiscal year 2009/10.

Estimated Revenue Impact of Withholding Provision Effective for Withholding Beginning On or After November 1, 2009 Enactment Assumed After 06/30/09 ($ in Millions)		
2009-10	2010-11	2011-12
$1,600	$1	$58

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

Revenue Discussion:

The revenue impact of this provision depends on the amount of additional withholding under the provision than otherwise under current law.

Based on projections of personal income tax withholding by the Department of Finance, an additional 10 percent withholding beginning on November 1, 2009, is estimated to generate $576 million for tax year 2009, $3.2 billion, for tax year 2010, $3.1 billion each for tax years 2011 and 2012. Based on departmental data the additional withholding would reduce final tax payments, normally received with a tax return when filed, by 25 percent for 2009 and 15 percent for 2010 and subsequent tax years. It is anticipated that 73 percent of 2009 and 83 percent of 2010 and subsequent years additional withholding would be refunded. The first fiscal year, 2009/10, would have a revenue gain of $1.6 billion ($2,200 million - $565 million).

Additional withholding for 2009	$ 576 million
50% of additional withholding for 2010	$1,600 million
	≈ $2,200 million
Reduced final payments in 2009	-$144 million
73% of additional withholding refunded in 2009/10	-$421 million
	-$565 million

In subsequent fiscal years, refunds of additional withholding and reduced final payments offset much of the additional withholding.

PROVISION NO. 2: MODIFY ESTIMATED TAX PAYMENT PERCENTAGES

EFFECTIVE/OPERATIVE DATE

As a special session bill, this provision would become effective on the 91st day after the close of the special session. The operative dates vary for certain aspects of this provision. The various operative dates are identified in the "THIS PROVISION" section.

ANALYSIS

STATE LAW

In general, prior California law required individual and corporate taxpayers to remit four estimated tax payments each equal to 25 percent of their required annual payment. Recently enacted state law, SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1), changed the required applicable percentages so that the estimated tax payments for taxable years beginning on or after January 1, 2009, is now 30 percent, 30 percent, 20 percent, and 20 percent for the 1st, 2nd, 3rd, and 4th quarter installments, respectively.

Current state law requires the "annual payment" for an individual to be the lesser of the following:

- Option 1: 90 percent of the tax shown on the return for the taxable year, or
- Option 2: 100 percent of the tax shown on the return for the preceding taxable year.

In addition, current state law requires the annual payment under option 2 to be increased from 100 percent to 110 percent of the tax shown on the return if the adjusted gross income (AGI) of the taxpayer for the preceding taxable year exceeds $150,000 ($75,000 in the case of a married individual filing a separate return). SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1) modified the options above to provide additionally that a taxpayer with AGI equal to or greater than $1 million ($500,000 in the case of a married individual filing a separate return) may not use option 2 for taxable years beginning on or after January 1, 2009.

Under existing state law and unchanged by SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1), the "annualized income installment method" allows a taxpayer to calculate the required estimated tax payment based on an estimate of income, deductions and credits attributable to each installment period[1]. The computation of estimated tax payments under the "annualized income installment method" requires the annualized tax due for each installment period to be multiplied by an increasing percentage of 22.5 percent, 45 percent, 67.5 percent, and 90 percent. The percentages used in the calculation equate to 25 percent, 50 percent, 75 percent, and 100 percent of the required annual payment under Option 1.

Under previously existing state law and not explicitly changed by recently enacted state law, wage withholding is equally applied 25 percent, 25 percent, 25 percent, and 25 percent as quarterly installments toward a taxpayer's required annual payment.

Generally, a taxpayer is subject to a penalty for any underpayment of estimated tax. The penalty is an amount equal to the underpayment rate multiplied by the amount of the underpayment. The underpayment rate is the same as the interest rate charged for tax delinquencies, currently 5 percent. The penalty is calculated by comparing the required amount for each estimated tax payment, determined under either the regular method (formerly 25 percent, 25 percent, 25 percent, 25 percent, now 30 percent, 30 percent, 20 percent, 20 percent) or the "annualized income installment method", with the amount paid by the due date of that installment.

<u>THIS PROVISION</u>

This provision would:

1. Provide explicit authority for FTB to apply wage withholding in percentages consistent with the percentages required for estimated tax payments for taxable years beginning on or after January 1, 2009.

2. Revise the percentages used to determine estimated tax payment requirements under the annualized income installment method to percentages consistent with SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1) for taxable years beginning on after January 1, 2009, and before January 1, 2010.

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[1] A taxpayer whose income fluctuates throughout the year may have a lower required installment using the "annualized income installment method".

3. Eliminate the 3rd quarter estimated tax payment by revising the estimated tax payment percentages. The percentages would be 30 percent, 40 percent, 0, and 30 percent for the 1st, 2nd ,3rd, and 4th quarter installments for taxable years beginning on or after January 1, 2010. Corporations not required to make an estimated tax payment for the first quarter would be required to make estimated tax payments of 60 percent, 0, and 40 percent for the 2nd, 3rd, and 4th quarter installments, respectively. Corporations not required to make an estimated tax payment for the first and second quarter would be required to make estimated tax payments of 70 percent, and 30 percent, for 3rd, and 4th quarter installments, respectively.

4. Revise the percentages used to determine estimated tax payment requirements under the annualized income installment method to percentages consistent with percentages in item 3 above for taxable years beginning on or after January 1, 2010.

LEGISLATIVE HISTORY

ABX3 19 (Evans, 2009/2010) and SBX3 17 (Ducheny, 2009/2010), in addition to other unrelated provisions, contain provisions similar to this provision. ABX3 19 was approved by the Senate and Assembly on June 30, 2009, and July 1, 2009, respectively, but has yet to be enrolled and sent to the Governor. SBX3 17 was vetoed by the Governor on June 30, 2009. In his veto message, Governor Schwarzenegger stated, "I have been very clear that the Legislature must solve the entire deficit, must make the hard decisions now, and must not push the problem off to tomorrow. This bill and its companion measure, SBX3 16, do not meet any of those criteria."

AB 1546 (Assembly Revenue & Taxation Committee, 2009/2010) contains provisions that would revise the percentages used to determine estimated tax payment requirements under the annualized income installment method to percentages consistent with SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1). This bill is currently waiting to be heard in the Senate Appropriations Committee.

SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1) changed the required estimated tax payment percentages to 30 percent, 30 percent, 20 percent, and 20 percent for the 1st, 2nd, 3rd, and 4th quarter installments, respectively.

OTHER STATES' INFORMATION

Because this provision would modify estimated tax payment percentages unique to California, a comparison of other states is unnecessary.

FISCAL IMPACT

Implementing this provision would require the department to make changes to existing computer systems and tax forms and instructions. The department estimates one-time cost would be approximately $100,000.

ECONOMIC IMPACT

Revenue Estimate:

Based on the data and assumptions discussed below, this provision would result in the following annual revenue gains beginning in fiscal year 2009/10.

Estimated Revenue Impact of Estimated Tax Provision Effective for Taxable Years Beginning On or After January 1, 2010 Enactment Assumed After 06/30/09 ($ in Millions)		
2009-10	2010-11	2011-12
$600	$19	$37

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

Revenue Discussion:

The revenue impact of the provision depends on the amount of additional estimated tax payments under this provision than otherwise under current law.

This proposal would shift to the prior fiscal year half of the estimated tax payments normally made in the September installment. The Department of Finance projected the total of September 2010 estimated tax payments to be $3.7 billion. Under this proposal half of the $3.7 billion, or $1.8 billion, would be remitted in June 2010. Current law requires one - third of September's estimated tax payments, or $1.2 billion ($3.7 billion / 3), to be accrued to the prior fiscal year. Therefore, $1.2 billion is subtracted from the accelerated $1.8 billion resulting in a revenue gain in fiscal year 2009/10 of $600 million. For fiscal year 2010/11 the prior year acceleration of $600 million offsets the subsequent year's acceleration of estimated tax payments resulting in a revenue gain estimated to be $19 million. The revenue from accelerating estimated tax payments assumes the acceleration applies to both quarterly and annualized installment payments.

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