ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Wyland	Analyst:	Matthew Cooling	Bill Number:	SB 952
Related Bills:	See Legislative History	Telephone:	845-5983	Introduced Date:	February 4, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Repeal PIT Temporary Rate Increases/Repeal Decreased Personal Exemption Credit for Dependents/Withholding Tables/Eliminate 10 Percent Increase

SUMMARY

This bill would do the following:

- Repeal the increases to sales and use tax rates and vehicle license fees,
- Repeal the increase in personal income tax (PIT) and alternative minimum tax (AMT) rates,
- Repeal the reduction of the dependent exemption credit, and
- Repeal the 10 percent increase in withholding.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide tax relief to taxpayers to help revitalize the economy, bring back jobs, and provide financial stability to the state.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective immediately upon enactment.

The repeal of the sales and use tax increase provisions would be specifically operative for tax years beginning on or after January 1, 2009, and before the first day of the quarter beginning 91 days after this bill is enacted.

The repeal of the vehicle license fee increase provisions would be specifically operative for vehicles assessed on or after the date of enactment for this bill.

The provisions that would repeal the PIT and AMT rate increase and the dependent exemption credit decrease would be specifically operative for taxable years beginning on or after January 1, 2010.

The repeal of wage withholding increase provisions would be operative for wages paid on or after the effective date.

Board Position:			Department Director	Date
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POSITION

Pending.

Repeal the Sales and Use Tax Rate Increases and the VLF Increases

ANALYSIS

STATE LAW

Legislation enacted in 2009, ABX3 3 (Evans, Stats. 2009, 3rd Ex. Sess. 2009/2010, Ch. 18), among other things, increased the sales and use tax rates from 7.25 percent to 8.25 percent. Of the 8.25 percent base rate, 7.25 percent is the State portion and is allocated as follows:

- 6.00 percent is deposited in the General Fund,
- 0.25 percent is deposited in the Fiscal Recovery Fund,
- 0.50 percent is deposited in the Local Public Safety Fund, and
- 0.50 percent is deposited in the Local Revenue Fund.

The remaining 1 percent is the local portion and is allocated as follows:

- 0.25 percent is allocated to fund county transportation, and
- 0.75 percent is allocated to fund various other city and county operations.

Current law also authorizes the Department of Motor Vehicles to collect the VLF of 1.15 percent of the depreciated value of the vehicle for automobiles, commercial vehicles with a declared gross operating weight under 10,001 pounds, motorcycles, and trailer coaches.

Federal law allows taxpayers to deduct the amounts of sales and use tax paid and the VLF on the personal income tax returns as itemized deductions. State law allows taxpayers to deduct sales and use tax paid as a business expense under Corporate Tax Laws, but not under Personal Income Tax Laws (PITL).

THESE PROVISIONS

These provisions would repeal the sales and use tax rate increases enacted in 2009 and restore the statewide rate to 7.25 percent. The provisions would also reduce the VLF from 1.15 percent to 0.65 percent of the depreciated value of the vehicle. As a result, these provisions would reduce the amount of sales and use tax and VLFs deductible on the State income tax return.

Repeal the Increase in the PIT and AMT Rates

ANALYSIS

FEDERAL/STATE LAW

Federal tax law imposes six different income tax rates on individuals, estates, and trusts ranging from 10 percent to 35 percent.

For taxable years beginning on or after January 1, 2009, and before January 1, 2011, state tax law imposes six different rates under the PITL ranging from 1.25 percent to 9.55 percent. Each tax rate applies to different ranges of income, known as “tax brackets.” Current state tax law requires the Franchise Tax Board (FTB) to recalculate the tax brackets each year based on the change in the California Consumer Price Index (CCPI).

For taxable years beginning on or after January 1, 2005, state law imposes an additional 1 percent Mental Health Tax (MHT), not subject to reduction by credits, on the portion of a PIT taxpayer’s taxable income that exceeds $1 million. The taxable income threshold of $1 million is not indexed based on changes in the CCPI. The MHT is subject to estimated tax payment requirements, interest, penalty, and other tax administration rules applicable to other taxes imposed under the PITL.

Federal law provides an AMT rate of 26 percent on alternative minimum taxable income up to $175,000 and 28 percent on AMT taxable income exceeding that amount for PIT taxpayers. Existing state law provides an AMT rate of 7.25 percent under the PIT law for taxable years beginning on or after January 1, 2009, and before January 1, 2011. A taxpayer with substantial income can use preferential tax benefits, such as exclusions, deductions, and credits, to reduce their income tax liability. AMT was established to ensure that a taxpayer who can use preferential tax benefits does not completely escape taxation.

THIS PROVISION

This provision would repeal the statute that increased the PIT and AMT tax rates by 0.25 percent for taxable years beginning on or after January 1, 2010.

FISCAL IMPACT

This provision would not significantly impact the department’s costs.

Repeal the Reduction of the Dependent Exemption Credit

ANALYSIS

FEDERAL/STATE LAW

Overview

Federal and state law both provide “personal-exemption” type reductions to tax; however, federal law provides a “personal-exemption” deduction, whereas the state provides a “personal-exemption” tax credit. An exemption deduction is a reduction to adjusted gross income (AGI)[1] to arrive at taxable income, whereas a tax credit is a dollar-for-dollar reduction to tax.

[1] For purposes of state income tax law, AGI is defined by cross-reference to the Internal Revenue Code (IRC) as gross income, which includes all income from whatever source derived, adjusted for certain allowable amounts, including IRA contributions, alimony paid, moving expenses, and Keogh account contributions.

Federal Law

Federal law provides a "personal-exemption" deduction.[2] Taxpayers are generally allowed one exemption for each individual and one exemption for each qualifying child or dependent. Each exemption is worth the same amount, and taxpayers multiply the total number of exemptions by the current-year exemption amount. The exemption deduction amount is $3,650 for taxable year 2009, and is adjusted annually based on the Consumer Price Index published by the Department of Labor. The amount of the exemption for senior, blind, and disabled taxpayers is more.

State Law

Legislation enacted in 2009, ABX3 3 (Evans, Stats. 2009, 3rd Ex. Sess. 2009/2010, Ch. 18), temporarily reduces the amount of the dependent exemption credit from $309 in 2008 to an amount equal to the personal exemption credit. This reduction is effective for the 2009 and 2010 taxable years. For 2009, the reduced personal exemption, senior exemption, blind exemption, and dependent exemption credit amounts are $98.[3]

<u>THIS PROVISION</u>

This provision would repeal the reduction of the dependent exemption credit enacted in 2009 for taxable years beginning on or after January 1, 2010. After the reduction ceases to apply, the dependent exemption credit would be increased to the amount it would have been if the reduction had never become operative.

FISCAL IMPACT

This provision would not significantly impact the department's costs.

Repeal of the 10 Percent Increase in Withholding

ANALYSIS

<u>STATE LAW</u>

Current state law requires the FTB on an annual basis 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. Legislation enacted in 2009 requires the amount determined for the withholding tables to be increased by 10 percent. 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 6.6 percent for supplemental wages other than stock options and bonus payments. The rate of withholding for stock options and bonus payments is 10.23 percent.

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[2] IRC section 151.
[3] R&TC section 17054.

Taxpayers are required to make estimate payments if the amount of taxes withheld or otherwise available for a taxable year is less than the amount due. Penalties are imposed if the estimated taxes are underpaid.

THIS PROVISION

This provision would repeal the 10 percent increase in PIT withholding rates enacted in 2009, operative for wages paid after the effective date of this bill. This provision would also repeal, as of the effective date, the increase in withholding rates for supplemental wages other than stock options and bonus payments, restoring it to 6 percent. The rate of withholding for stock options and bonus payments would be restored to 9.3 percent.

FISCAL IMPACT

This provision would not significantly impact the department's costs.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update. As a result, this bill would not significantly impact the department's programs and operations.

TECHNICAL CONSIDERATION

Amendment 1 provides a technical amendment that clarifies the language of the bill regarding the operative period of the dependent exemption credit reduction. Amendments 2 through 6 provide minor technical amendments related to cross-referencing in the bill.

LEGISLATIVE HISTORY

AB 1700 (Gains, 2009/2010) would repeal the same provisions as this bill with the exception of the 10 percent withholding rate increase. This bill will be heard in the Assembly Revenue and Taxation Committee on May 10, 2010.

AB 1959 (Logue, 2009/2010) and AB 2225 (Gaines, 2009/2010) would limit the 10 percent withholding increase on wages, supplemental wages, stock options, and bonus payments to amounts paid on and after November 1, 2009, and before January 1, 2011. AB 1959 is currently on the suspense file in the Assembly Revenue and Taxation Committee; AB 2225 is scheduled to be heard in the Assembly Revenue and Taxation Committee on May 10, 2010.

ABX3 3 (Evans, Stats. 2009, 3rd Ex. Sess. 2009/2010, Ch. 18) added 0.25 percent to each PIT rate for taxable years 2009 and 2010 and reduced the dependent exemption credit to the same amount as the personal exemption credit for taxable years 2009 and 2010. This bill also increased the state sales and use tax rate by one percent.

ABX1 2 (Evans, 2009/2010) would have, among other things, imposed a 2.5 percent additional tax on the total tax for all personal income taxpayers and require FTB to report the revenue increase to the Department of Finance. This bill was vetoed by Governor Schwarzenegger on January 6, 2009. The veto message is provided below in Appendix A.

SB 96 (Ducheny, 2009/2010) would modify and add PIT rates of 9 percent, 9.5 percent, 10 percent, 10.5 percent, 11 percent and would increase the AMT rate for 8.5 percent. This bill is currently in the Senate Revenue and Taxation Committee.

ECONOMIC IMPACT

Revenue Impact

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 952 Effective On or After June 30, 2010, for Taxable Years Beginning On or After January 1, 2010 Enactment Assumed September 30, 2010 ($ in Millions)			
	2010-11	**2011-12**	**2012-13**
Repeal of 1% Increase in Sales and Use Tax	+$20	+$2.6	+$2.6
Repeal of 0.5% Increase in Vehicle License Fees	+$36		
Repeal of the Increase in the PIT and AMT Rates	-$1,900		
Repeal of the Reduction of the Dependent Exemption Credit	-$1,200		
Interaction between the PIT/AMT Rates and the Dependent Exemption Credit	+$200		
Repeal of 10% Increase in Withholding	-$1.400	-$170	-$75
Total Estimated Net Revenue Impact for SB 952	-$4,244	-$167	-$72

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

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 952
As INTRODUCED FEBRUARY 4, 2010

AMENDMENT 1

On page 12, line 27, after "operative", strikeout "on" and insert:

for taxable years beginning on or after

AMENDMENT 2

On page 12, strikeout lines 31 to 34, inclusive and insert:

<u>(B) For taxable years beginning on or after January 1, 2010, the credit allowed under paragraph (1) for each dependent shall be equal to the amount that would be allowed if subparagraph (A) had never been operative.</u>

AMENDMENT 3

On page 19, line 28, strikeout "this section" and insert:

this paragraph

AMENDMENT 4

On page 20, line 1, strikeout "this section" and insert:

this subparagraph

AMENDMENT 5

On page 20, line 14, strikeout "paragraph (2)" and insert:

paragraph (1)

AMENDMENT 6

On page 20, line 16, strikeout "this section" and insert:

this paragraph

APPENDIX A

BILL NUMBER: ABX1 2
VETOED   DATE: 01/06/2009

January 6, 2009

To the Members of the California State Assembly:

I am returning Assembly Bill X1 2 without my signature because it is part of a bill package that does not deal with California's current budget and economic crisis. This bill package punishes Californians by raising revenue without providing permanent and ongoing cuts, does not create jobs or stimulate our economy, does not allow government to run more efficiently in California, and makes no attempt to keep people in their homes.

Sincerely,

Arnold Schwarzenegger