

# ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Wyland Analyst: Jahna Alvarado Bill Number: SCA 33  
Related Bills: See Legislative History Telephone: 845-5683 Introduced Date: August 30, 2010  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Expenditure Limit/50% of Excess Revenue That May Be Deposited Into The Reserve Account Shall Be Paid To Personal Income Taxpayers As Rebates

## SUMMARY

This measure would require a portion of revenues in excess of the amount that may be deposited into the reserve account to be rebated to personal income tax (PIT) 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.

## PURPOSE OF THE BILL

According to the author's office, the purpose of this measure is to return the state to fiscal responsibility by restoring a strong spending limitation to state government.

## EFFECTIVE/OPERATIVE DATE

As a constitutional amendment, this measure would become effective and operative the day following approval by the voters in the next general election following approval of the measure by the Legislature.

## POSITION

Pending.

## ANALYSIS

### FEDERAL/STATE LAW

Currently, specific provisions of Article XIII B of the California Constitution:

- Prohibit a governmental entity's annual appropriation from exceeding its annual limit, which is adjusted annually for the cost of living and population changes.

Board Position:

\_\_\_\_\_ S      \_\_\_\_\_ NA      \_\_\_\_\_ NP  
\_\_\_\_\_ SA      \_\_\_\_\_ O      \_\_\_\_\_ NAR  
\_\_\_\_\_ N      \_\_\_\_\_ OUA        X   PENDING

Department Director

Date

Patrice Gau-Johnson  
for Selvi Stanislaus

10/21/10

➤ Provide that:

- 50 percent of the revenues received by the state in a fiscal year and the next fiscal year that are in excess of the amount that may be appropriated by the state for the same fiscal years, are transferred to the State School Fund.
- The remaining 50 percent of the excess revenues must be returned by the state by revising the personal income tax rates or fee schedules within the next two subsequent fiscal years.

For federal income tax purposes, refunded state income taxes previously claimed as an itemized deduction must be reported as income on the federal return for the taxable year in which refunded.

THIS MEASURE

This measure would repeal and replace Article XIII B of the California Constitution. Specifically, this measure would include 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 received in excess of the amount that may not be spent in the current fiscal year due to the spending limit above shall be allocated as follows:
  - To the Special Reserve Account within the General Fund, so long as this account contains an amount no greater than 10 percent of the total amount of allowable spending for the current fiscal year. Money in the reserve account may be spent subject to the specifications of this measure.
  - Revenue in excess of the 10 percent allowed for the Special Reserve Account shall be allocated as follows:
    - 50 percent transferred to the State School Fund.
    - 50 percent paid as a rebate to all PIT taxpayers. The rebate would be proportionate to the tax liability for the tax year that encompasses the first half of the current fiscal year for which the excess exists.
- 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 the FTB to oversee the issuance of rebates because the amount of the rebate is related to the taxpayer's tax liability on their PIT 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 the 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 PIT 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 the 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 each taxpayer's 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 all PIT taxpayers—including part year and nonresidents, trusts, and estates—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 PIT taxpayer's tax liability, but fails to specify when the rebates should be issued. PIT 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, the 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 2010 taxable year may be filed until October 15, 2011, and most of the processing completed by April of 2012. Therefore, if the state has excess revenues for the 2010/2011 fiscal year, the FTB may be able to begin calculating the rebates in April 2012 based on the 2010 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. To avoid situations requiring a rebate revision, the author may wish to amend this measure to specify that the rebate calculation would be based on timely filed original returns.
- Currently, the FTB, IRS, and other state agencies participate in an offset process where refunds are offset to satisfy an outstanding liability owed by the taxpayer to another government entity. Without clarification, rebate payments 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 the rebate 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.

This measure would become operative the day after receiving voter approval and would apply to the fiscal year that voter approval occurred in. If it is the author's intent that this measure would apply to fiscal years beginning on or after the date that this measure receives voter approval, the author may wish to amend this measure or clearly identify the first fiscal year that this measure would apply to in enabling legislation.

If the 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.

## **LEGISLATIVE HISTORY**

ACA 4 (Stats. 2010, Ch. 174) and SCA 10 (Ashburn, et al., 2009/2010) are essentially the same. Both sought to propose a constitutional amendment that would provide for the prioritized use of state revenue in excess of appropriations, including the return of excess unanticipated revenues to taxpayers through a one-time change in tax rates or by rebates. ACA 4 was chaptered and the proposed constitutional amendment will be placed before the voters for approval. SCA 10 failed to pass out of the Senate by the constitutional deadline.

ACA 3 (Gaines, et al., 2007/2008) would have required a percentage of the revenues in excess of the amount appropriated by the Legislature to be rebated to personal income taxpayers in proportion to their tax liability for the tax year. This measure was held in the Assembly Committee on Education.

SCA 2 (McClintock, et al., 2005/2006) and SCAX 2 (McClintock, 2005/2006) would have required revenues in excess of the amount appropriated by the Legislature to be rebated within 18 months to PIT return filers in proportion to social security taxes paid. Both measures were held in Senate policy committees.

SCA 23 (Morrow/McClintock, 2005/2006) would have required revenues in excess of the amount appropriated by the Legislature to be rebated in the following fiscal year to specified taxpayers. This measure was held in Senate policy committees.

SCA 3 (McClintock, et al., 2003/2004) would have required the FTB and the State Controller to issue rebates to taxpayers, on a pro rata basis, of a portion of the revenues received by the state in excess of the amount appropriated by the state during the fiscal year. This measure was held in the Senate Committee on Revenue and Taxation.

SCA 16 (McClintock, 2003/2004) would have required all excess state revenues to be returned via revision of the tax rates or fee schedules. This measure was held in the Senate Committee on Education.

ACA 6 (Campbell, 2003/2004) and SCA 16 (McClintock, et al., 2001/2002) would have required the FTB and the State Controller to issue rebates of excess revenues. These measures were held in policy committees.

AB 2609 (Stats. 1987, Ch. 915) and SB 47 (Stats. 1987, Ch. 908) authorized a tax rebate of excess funds for the 1986 taxable year. Qualified taxpayers were allowed a tax rebate of 15 percent of the tax imposed by the income tax law, as defined, with specified minimum dollar limits and maximum dollar limits. The rebate was calculated and administered by the FTB. The Controller was required to send rebate checks to taxpayers by January 15, 1988.

## **OTHER STATES' INFORMATION**

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

- *Florida*, which has no personal income tax, requires excess revenues to be refunded to taxpayers.
- *Massachusetts* allows a credit, called the "excess revenue credit," toward taxpayers' personal income tax liabilities.
- *Michigan* requires excess revenue to be refunded on a pro rata basis that is based on the liability reported on the Michigan income tax and single business tax returns.

A review of *Minnesota, New York* and *Illinois* state laws and constitutions did not produce any information regarding procedures for state revenues in excess of appropriations.

## **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 be required 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.

## **ECONOMIC IMPACT**

### Revenue Estimate

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

## **LEGISLATIVE STAFF CONTACT**

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