Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Evans	Analyst:	Deborah Barrett	Bill Number:	AB 1342
Related Bills:	See Legislative History	Telephone:	845-4301	Introduced Date:	February 27, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: County Personal Income Tax

SUMMARY

This bill would authorize the board of supervisors of any county to impose a county income tax to be administered by Franchise Tax Board (FTB) or a vehicle license fee administered by Department of Motor Vehicles or both.

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

This bill would be effective on January 1, 2010, and would be operative on or after that date.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current state law imposes a Vehicle License Fee (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.

Board Position:			Department Director	Date
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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.

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. Special taxes must be approved by two-thirds of the electorate.

THIS BILL

This bill would authorize the board of supervisors of any county to impose by ordinance either or both of the following:

- A personal income tax imposed on taxable income in a manner similar to the tax imposed under the Personal Income Tax Law. This county income tax would be administered by FTB. FTB would be responsible for transmitting all revenues less its costs of administration and any refunds to the county in which the tax is imposed.
- A license fee for the privilege of operating upon the public highways in the state, any vehicle of a type which is subject to registration under the Vehicle Code. The annual amount of the license fee for any vehicle shall not exceed 2 percent of the market value of that vehicle and shall be imposed in a manner similar to the fee imposed by the Vehicle License Fee Law. Department of Motor Vehicles (DMV) would be responsible for administering this fee. DMV would transmit all revenues less its costs of administration and any refunds to the county in which the tax is imposed.

This bill would require that the tax or fee be imposed in accordance with all applicable voter approval requirements imposed by law. The bill also provides legislative findings that it is appropriate and necessary to shift some authority and responsibility back to local government agencies to allow those agencies to determine the level of services appropriate for their citizens.

IMPLEMENTATION CONSIDERATIONS

This bill's directive for FTB to "administer" any county income tax imposed is vague and lacks specific parameters with which FTB would implement the provisions of this bill. Potentially, FTB could be responsible to administer 58 different county income tax programs. It is unclear what extent FTB's responsibility would include—accounting, collection, audit, assessment or appeals, and/or enforcement activities in "administering" the tax. It is recommended that parameters for administering the county income tax be specified to enable FTB to adequately assess the impact to the department for implementing the provisions of this bill and to ensure consistency, to the extent possible, among all 58 counties can be obtained.

This bill would require FTB to transmit all revenues less its costs of administration and any refunds to the county in which the tax is imposed. FTB lacks the expertise and systems to distribute funds. Generally, the state Controller is the agency that distributes amounts received by FTB to the appropriate funds.

Additionally, it is unclear how frequently funds are to be transmitted, how adjustments to accounts that result in over distribution to the county would be recouped, and how costs to administer the county tax would be reimbursed. It is recommended that parameters be established relating to the distribution of funds to ensure consistency among all counties that may assess an income tax to be administered by FTB.

TECHNICAL CONSIDERATION

Provisions under Part 10, Division 2 of the Revenue and Taxation Code expressly prohibit local income tax from being imposed, which conflicts directly with the provisions of this bill. It is recommended that the author repeal section 17041.5 to prevent any disputes between taxpayers and the department in administering the provisions of this bill.

LEGISLATIVE HISTORY

SB 10 (Leno, 2009) 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 was referred to the Senate Committees on Transportation and Housing and Revenue and Taxation.

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) 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.

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 1690 (Leno, 2003/2004) would have given 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.

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

An estimate of the fiscal impact to implement this bill cannot be determined until the implementation concerns identified above have been resolved. A cost estimate will be developed as the bill progresses through the legislative process.

ECONOMIC IMPACT

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB 1342 As Introduced 02/27/09 ($ in Millions)					
	2009-10	**2010-11**	**2011-12**	**2012-13**	**2013-14**
Deduction	0	0	-$360	-$320	-$320

Estimates assume all counties would begin imposing a VLF fee on January 1, 2011. Based on this assumption, the proposed local fee would begin to be deducted on the 2011 taxable year returns filed in 2012.

<u>Tax Revenue Discussion</u>

The revenue impact of this bill would be determined by the amount of additional vehicle license fees deducted on tax returns and the tax rates of taxpayers deriving a tax deduction benefit. The provision relating to local income taxation in this bill would not impact personal income or corporate tax revenues.

The Department of Finance's estimate of VLF remittances was utilized to determine the estimated vehicle values in 2011 of $349 billion. The estimate assumes each county will raise the local VLF to 2 percent of the vehicle value beginning in 2011. This would generate a total local VLF of $6.98 billion ($349 billion x 2% VLF).

If 50 percent of the $6.98 billion results in a tax deduction benefit to income and corporation taxpayers, applying an 8 percent tax rate yields a loss of approximately $279 million ($6.98 billion x 50% x 8%).

Taxable year estimates are converted to fiscal year cash flow estimates in the table. In the table above, deduction estimates reflect a reduction in tax liability and estimated payments for subsequent taxable years.

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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 citys 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 years 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 Californias congested freeways and improve our roadways. Finding new funds for Californias 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