Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Evans	Analyst:	Angela Raygoza	Bill Number:	ABX3 3
Related Bills:	See Legislative History	Telephone:	845-7814	Amended Date:	February 14 and 19, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT:	Temporary Increase PIT rates by .25% (or .125% Contingent upon a Notification Result)/Increase AMT rates to 7.25% (or 7.125% Contingent upon a Notification Result)/Decrease Dependent Exemption Credit

SUMMARY

This bill would, among other things, do the following:

- Temporarily increase the personal income tax (PIT) and alternative minimum tax (AMT) rates.
- Temporarily decrease the amount allowable as a tax credit for personal exemption for dependents.

This analysis only addresses the provisions of the bill that directly impact the Franchise Tax Board (FTB).

SUMMARY OF AMENDMENTS

The February 14, 2009, amendments would impose an additional PIT rate of 5% for 2009 and 2010. In addition, those amendments decrease the amount allowable as a tax credit for personal exemption for dependents.

The February 19, 2009, amendments would remove the additional PIT rate of 5% and add 0.25% or 0.125%, as specified, to each PIT and AMT rate for taxable years 2009 and 2010. In addition, those amendments would reduce the dependent exemption credit to the same amounts as the personal exemption credit.

The bill as introduced on January 5, 2009, and as amended January 7, 2009, expressed the intent of the Legislature to make changes related to the 2009 Budget.

This analysis addresses the bill as amended February 14, 2009, and February 19, 2009. This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the language of this bill, the purpose is to address the fiscal emergency declared by the Governor on December 19, 2008.

Board Position:			Department Director	Date
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_______ N	_______ OUA	____X___ PENDING		

EFFECTIVE/OPERATIVE DATE

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

POSITION

Pending.

<u>PROVISION 1:</u> Increase 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% to 35%.

State tax law imposes six different rates under the Personal Income Tax Law (PITL) ranging from 1% to 9.3%. Each tax rate applies to different ranges of income, known as “tax brackets.” In addition, current state tax law requires the 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% Mental Health Tax (MHT), not subject to reduction by credits, on the portion of a personal income 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.

On an annual basis, the 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% for supplemental wages other than stock options and bonus payments. The rate of withholding for stock options and bonus payments is 9.3%.

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 a taxpayer underpays estimate taxes.

Federal law provides an AMT rate of 26% on AMT income up to $175,000 and 28% on AMT income exceeding that amount for PIT taxpayers. Existing state law provides an AMT rate of 7% under the PITL. 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 adds 0.25% to each PIT rate for taxable years 2009 and 2010. If certain notification regarding funds related to the federal stimulus act is given by the Director of Finance (DOF) on or before April 1, 2009, then 0.125% will be added to each PIT rate.

In addition, this provision increases the AMT rate from 7% to 7.25% for all personal income taxpayers for taxable years 2009 and 2010. If certain notification regarding funds related to the federal stimulus act is given by the DOF on or before April 1, 2009, then the AMT rate will be 7.125% instead.

Additionally, if the DOF provides notification that an amendment to the California Constitution is approved at a statewide election held during the 2009 calendar year that limits the total amount that may be transferred from the Budget Stabilization Account, or any successor to that account, to the General Fund, then the increase in PIT and AMT rates described above would be extended for two additional taxable years, 2011 and 2012.

LEGISLATIVE HISTORY

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

ABX1 2 (Evans, 2009/2010) would have, among other things, imposed a 2.5% additional tax on the total tax for all personal income taxpayers and require FTB to report the revenue increase to the DOF. This bill was vetoed by Governor Schwarzenegger on January 6, 2009. Please see attachment for veto message.

AB 2372 (Coto, 2008) would have imposed an additional 1% tax on taxable income in excess of $1 million for the College Affordability Fund. This tax, combined with the existing MHT, would effectively create an 11.3% tax rate for PIT taxpayers with taxable income in excess of $1 million. AB 2372 failed to pass out of the Assembly Appropriations Committee.

AB 6 (Chan, 2005)) would have reestablished PIT rates of 10% and 11% and would have increased the AMT rate for PIT taxpayers to 8.5%, but also would have reduced the amount of tax paid under the increased tax rates by the amount of tax imposed under Proposition 63, the MHT. AB 6 failed to pass out of the house of origin by the constitutional deadline.
Proposition 63 (Steinberg), approved by voters in the November, 2004, General Election, imposes a 1% tax on taxable incomes in excess of $1 million to provide a dedicated funding source for the expansion of mental health treatment options for children, adults, and seniors.

AB 1403 (Coto, 2005), AB 4 (Chan, 2003), and SB 1255 (Burton, 2002) would have reestablished PIT rates of 10% and 11% and would have increased the AMT rate for PIT taxpayers to 8.5%. AB 1403 failed to pass the Assembly Revenue and Taxation Committee; AB 4 and SB 1255 failed to pass out of the house of origin by the constitutional deadline.

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 does not have a personal income tax. *Illinois, Massachusetts,* and *Michigan* impose a flat tax of 3%, 5.3%, and 4.35% respectively. *Minnesota* and *New York* have a progressive rate. *Minnesota* has a maximum tax bracket of $71,591 for single and $126,580 for joint filers, with a maximum tax rate of 7.85%. *New York* has a maximum tax bracket of $20,000 for single and $40,000 for joint filers, with a maximum tax rate of 6.85%.

These amounts and rates apply to returns filed in 2009 for the 2008 taxable year.

FISCAL IMPACT

This provision is not expected to significantly impact the department's cost.

ECONOMIC IMPACT

Revenue estimates for this provision were prepared by the DOF; accordingly, the department defers to DOF.

PROVISION 2: Dependent Exemption Credit Limitation

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 "personal-exemption" tax credits. An exemption deduction is a reduction to adjusted gross income (AGI) to arrive at taxable income, whereas a tax credit is a dollar-for-dollar reduction to tax.

Federal Law

Federal law provides a "personal-exemption" deduction.[1] Taxpayers are generally allowed one exemption for each individual and an exemption for each qualifying child. Each exemption is worth the same amount, and taxpayers multiply the total number of exemptions by the current-year exemption amount. The exemption deduction is $3,500 for taxable year 2008, and is adjusted annually based on the CCPI published by the Department of Labor. The amount of the exemption for senior, blind, and disabled taxpayers is more.

[1] IRC section 151.

The exemption deduction is reduced if a taxpayer's federal AGI exceeds the threshold amount. For taxable year 2008, the exemption deductions are reduced for taxpayers with federal AGI of more than:

- Single $159,950
- Married filing joint $239,950
- Married filing separate $119,975
- Head of Household $244,785

The phase-out amounts are adjusted annually based on the CCPI published by the Department of Labor.

State Law

In general, individual taxpayers are allowed "personal-exemption" tax credits, as shown below:[2]

Exemption Type	Number of Exemptions	Exemption Amount[3]
		2008
Personal Exemption	One exemption for themselves, and one for a spouse, if married filing joint (MFJ).	$99
Senior	One additional exemption if 65 or older, and one for a spouse 65 or older, if MFJ.	$99
Blind	One additional exemption if visually impaired and one for a visually impaired spouse.	$99
Dependent	One exemption for each qualifying dependent.	$309

The exemption credits are reduced if a taxpayer's federal AGI exceeds a threshold amount.[4] For taxable year 2008, the exemption credits are reduced if federal AGI is more than:

- Single or Married/Registered Domestic Partner (RDP) filing separate $163,187
- Married/RDP filing joint $326,379
- Head of Household $244,785

[2] R&TC section 17054.
[3] The exemption credits are adjusted annually based on the California Consumer Price Index.
[4] The phase-out thresholds are adjusted annually based on the California Consumer Price Index.

THIS PROVISION

This provision reduces the dependent exemption credit to be the same amount as the personal exemption credit in taxable years 2009 and 2010. If the Director of DOF provides notification, as specified,[5] the reduction is extended two additional taxable years, 2011 and 2012. After the reduction ceases to apply, the dependent exemption credit is increased to the amount it would have been if the reduction had never been operative.

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.

The following states allow a dependent exemption:

- *New York* has a dependent only exemption of $1,000 per dependent.
- *Illinois* has a dependent exemption of $2,000 per dependent.
- *Massachusetts* has a dependent only exemption of $1,000 per dependent.
- *Michigan* has a dependent exemption of $3,500 per federal exemption.
- *Minnesota* has a dependent exemption of $3,500 per federal exemption.

Florida does not have a personal income tax; therefore, a comparison to *Florida* is not relevant.

FISCAL IMPACT

This provision is not expected to significantly impact the department's cost.

ECONOMIC IMPACT

Revenue estimates for this provision were prepared by the DOF; accordingly, the department defers to DOF.

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[5] The Director of Department of Finance is required to notify the Joint Legislative Budget Committee, the Executive Officer of the Franchise Tax Board, the Executive Director of the State Board of Equalization, and the Director of the Department of Motor Vehicles if an amendment to the California Constitution, approved at a statewide election held during 2009, limits the amount that may be transferred from the Budget Stabilization Account, or any successor to that account, to the General Fund.

Attachment

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