Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Skinner	Analyst:	Brian Werking	Bill Number:	AB 1130
Related Bills:	See Legislative History	Telephone:	845-5103	Introduced Date: / Amended Date:	February 18, 2011 / March 25, 2011
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: PIT Tax Rates/Increase to 10.3% For Taxable Income Over $500,000 Beginning January 1, 2011

SUMMARY

This bill would establish a 10.3 percent income tax rate on taxable income over $500,000.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

Summary of Amendments

The March 25, 2011, amendments removed language that would have made technical, non-substantive changes to the Revenue and Taxation Code and added provisions that would establish a 10.3 percent income tax rate on taxable income over $500,000. This is the department's first analysis of the bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to increase the tax on the top income earners to reduce the budget deficit.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2011.

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.

State tax law, for taxable years beginning on or after January 1, 2011, imposes six different rates under the Personal Income Tax Law (PITL) ranging from 1 percent to 9.3 percent. For taxable years beginning on or after January 1, 2009, and before January 1, 2011, each of the six tax rate percentages was increased by an additional 0.25 percent. Each tax rate applies to different ranges of income, known as "tax brackets." Current state tax law requires the Franchise Tax Board to recalculate the tax brackets each year based on the change in the California Consumer Price Index (CCPI).

Board Position:			Executive Officer	Date
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State tax law imposes separate income tax brackets for individuals filing as head of household and other individuals. Tax rates for individuals filing as head of household are imposed at a higher income bracket than those same rates imposed on individuals not filing as head of household. For example, for the 2010 taxable year, an individual filing as single or married/registered domestic partner filing separately is subject to a 9.55 percent tax rate for taxable income over $46,766; an individual filing as head of household is subject to 9.55 percent tax rate for taxable income over $63,657.

State tax law uses the tax brackets for individuals not filing as head of household to determine the tax rate for married individuals/registered domestic partners filing jointly. The joint taxable income of married couples/registered domestic partnerships filing jointly is halved and then applied to the appropriate individual tax bracket to determine the tax rate. The appropriate tax rates are applied to half of the joint income and the resulting amount is doubled to determine the tax due for married couples/registered domestic partnerships filing jointly.

The 1 percent mental health services tax is imposed on taxable income in excess of $1,000,000. This additional tax is applied to the joint taxable income of married couples/registered domestic partnerships filing jointly, as if their joint income was that of an individual—without the operation of halving to determine the imposition of the additional 1 percent tax.

THIS BILL

This bill would establish a 10.3 percent tax rate for individuals, individuals filing as head of household, married individuals/registered domestic partners filing jointly, and married individuals/registered domestic partners filing separately, for taxable income over $500,000 for taxable years beginning on or after January 1, 2011. The over $500,000 tax bracket would apply equally to the taxable income of individuals, individuals filing as head of household, individual income of married individuals/registered domestic partners filing separately, and the joint income of married individuals/registered domestic partners filing a joint return.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

The language contained in this bill is unclear in its application of the 10.3 percent tax rate. The usage of the word “instead” in reference to the 9.3 percent tax rate may be interpreted to replace the 9.3 percent tax rate with the 10.3 percent tax rate. If this is contrary to the author’s intent, the author may wish to amend the language of the bill to prevent any confusion.

The language contained in this bill fails to specifically indicate the first year in which the $500,000 tax bracket would be indexed. To prevent any confusion, the author may wish to amend the bill specifying the base year to which the $500,000 tax bracket applies and the year in which indexing begins.

TECHNICAL CONSIDERATIONS

This bill lacks statutory tax levy language.

On page 5 after line 38, insert “SEC 2. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.”

LEGISLATIVE HISTORY

See Appendix A.

PROGRAM BACKGROUND

In the early 1990s, California faced a severe recession, which resulted in significant shortfalls in the state budget. In response, the state acted to increase revenues and reduce expenditures. As one way of increasing revenues, the state imposed a temporary income tax rate increase[1] for taxable years beginning on or after January 1, 1991, and before January 1, 1996. The law added PIT rates of 10 percent for taxable incomes in excess of $100,000 and 11 percent for taxable incomes in excess of $200,000.

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 has increased their flat PIT rate from 3 percent to 5 percent for taxable years beginning on and after January 1, 2011.

Massachusetts has not changed their flat PIT rate of 5.3 percent.

Michigan has reduced their flat PIT rate from 4.35 percent to 4.25 percent for taxable years beginning on or after October 1, 2011.

Minnesota has a maximum tax bracket of $74,780 for single and $132,200 for joint filers, with a maximum tax rate of 7.85 percent.

New York has a maximum tax bracket of $500,000 for both single and joint filers, with a maximum rate of 8.97 percent.

FISCAL IMPACT

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

[1] SB 169 (Alquist, Stats. 1991, Ch. 117.)

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 1130 For Taxable Years Beginning On or After January 1, 2011 Enactment Assumed After June 30, 2011 ($ in Billions)		
2011-12	2012-13	2013-14
-$2.1	-$1.5	-$1.6

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Pro: It could be argued that the proposed tax increase would provide a much needed revenue source to help reduce the multi-billion dollar deficit facing the state of California.

Con: It could be argued that the proposed tax increase will discourage growth and investment in California.

POLICY CONCERNS

For taxable incomes greater than $500,000, this bill would replace the 9.3 percent tax rate with a 10.3 percent tax rate. This would create a more progressive result—reducing the tax rate from 9.3 percent to 8 percent for individuals with taxable incomes from $46,766 to $500,000, while increasing the tax rate from 9.3 percent to 10.3 percent for taxable incomes greater than $500,000 and from 10.3 percent to 11.3 percent for taxable incomes greater than $1,000,000.

This bill would increase the tax rate from 9.3 percent to 10.3 percent on taxable incomes greater than $500,000, and would apply equally across filing statuses. The application of the increased tax rate regardless of filing status would encourage affected married individuals/registered domestic partners to file separately to reduce their overall tax burden. If the author intends to prevent this result, the author may wish to amend the language to equalize the tax treatment of married individuals/registered domestic partners filing separately and married individuals/registered domestic partners filing jointly.

LEGISLATIVE STAFF CONTACT

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Appendix A
Legislative History

Bill Number	Action	Status
AB 1836 (Furutani, 2009/2010)	Would have temporarily increased the two highest PIT rates and the AMT rate.	Failed passage out of the first house.
SB 96 (Ducheny, 2009/2010)	Would have added four higher tax brackets with higher tax rates.	Failed passage out of the first house.
ABX3 3 (Evans, Stats. 2009, 3d. Ex. Sess. 2009/2010, Ch. 18)	Temporarily increased PIT and AMT rates.	Chaptered February 20, 2009.
AB 2897 (Hancock, 2007/2008)	Would have established two higher tax brackets with higher tax rates.	Failed passage out of the Assembly Revenue and Taxation Committee.
AB 6 (Chan, 2005/2006)	Would have established two higher tax brackets with higher tax rates and increased the AMT rate, giving a credit for the tax imposed by Proposition 63.	Failed passage out of the first house.
AB 1403 (Coto, 2005/2006)	Would have established two higher tax brackets with higher tax rates and increased the AMT rate.	Failed passage out of the Assembly Revenue and Taxation Committee.
AB 4 (Chan, 2003/2004)	Would have established two higher tax brackets with higher tax rates and increased the AMT rate.	Failed passage out of the first house.
Proposition 63 (Steinberg)	Imposed a 1 percent tax on taxable incomes over $1 million.	Approved by the voters in the November 2004 General Election.
SB 1255 (Burton, 2001,2002)	Would have established two higher tax brackets with higher tax rates and increased the AMT rate.	This bill was held in the Assembly Revenue and Taxation Committee.
SB 169 (Alquist, Stats.1991, Ch. 117)	Temporarily established two higher tax brackets with higher tax rates and increased the AMT rate.	Chaptered July 16, 1991.