

# ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Furutani Analyst: Brian Werking Bill Number: AB 1239  
Related Bills: See Legislative History Telephone: 845-5103 Introduced Date: February 18, 2011  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** PIT Rates/Increase Maximum Rates To 10 Percent & 11 Percent & AMT To 8.5 Percent

## SUMMARY

This bill would temporarily establish personal income tax (PIT) rates of 10 percent and 11 percent and would temporarily increase the alternative minimum tax (AMT) rate to 8.5 percent.

## RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

### Summary of Suggested Amendments

Amendments have been provided to resolve issues discussed below in "Technical Considerations."

## PURPOSE OF THE BILL

According to the language of this bill, the purpose is to provide a steady revenue stream that gives funding for education and vital health and safety services.

## EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. The PIT rate change provisions would be specifically operative for taxable years beginning on or after January 1, 2012, and before January 1, 2017. The AMT rate change provisions would be specifically operative for taxable years beginning on or after January 1, 2011, and before January 1, 2017.

## 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:

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

Executive Officer

Date

Selvi Stanislaus

05/10/11

Current state law imposes an additional 1 percent Mental Health Tax (MHT), not subject to reduction by credits, on the portion of a 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.

The AMT was established to ensure that a taxpayer who can use preferential tax benefits does not completely escape taxation. Federal law provides an AMT rate of 26 percent on alternative minimum taxable income up to \$175,000 and 28 percent on alternative minimum taxable income exceeding that amount for PIT taxpayers. Current state PITL provides an AMT rate of 7 percent for taxable years beginning on or after January 1, 2011.

### THIS BILL

This bill, for taxable years beginning on or after January 1, 2012, and before January 1, 2017, would establish a PIT rate of 10 percent for the following:

- Single filers (including married/registered domestic partners (RDPs) filing separate, trusts, and estates) whose taxable income is over \$250,000 and equal to or less than \$400,000,
- Joint filers whose taxable income is over \$500,000 and equal to or less than \$800,000, and
- Head of household filers whose taxable income is over \$400,000 and equal to or less than \$600,000.

This bill, for taxable years beginning on or after January 1, 2012, and before January 1, 2017, would establish a PIT rate of 11 percent for the following:

- Single filers (including married/RDPs filing separate, trusts, and estates) whose taxable income is over \$400,000,
- Joint filers whose taxable income is over \$800,000, and
- Head of household filers whose taxable income is over \$600,000.

This bill, for taxable years beginning on or after January 1, 2011, and before January 1, 2017, would increase the AMT rate from 7 percent to 8.5 percent.

This bill specifies that the amount of tax imposed by the increased tax rates would be reduced on a dollar-for-dollar basis by an amount equal to the MHT imposed. For example, a taxpayer whose taxable income is \$1.5 million would be subject to a \$5,000 MHT, to be deposited into the Mental Health Services fund. Under this bill, the \$5,000 MHT imposed would be subtracted from the amount of the taxpayer's total tax liability under the increased rates imposed under the bill.

### 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.

## TECHNICAL CONSIDERATIONS

This bill contains a nonsubstantive clerical error. Amendment 1 is provided to correct this error.

This bill would create two new PIT brackets for taxable years beginning on or after January 1, 2012, and would increase the AMT rate for taxable years on or after January 1, 2011. This operative date discrepancy between the two provisions may lead to confusion. Amendments 2 through 5 are provided to remedy this discrepancy.

## **LEGISLATIVE HISTORY**

AB 1130 (Skinner, 2011/2012) would replace the 9.3 percent personal income tax rate with a 10.3 percent personal income tax rate for taxable income in excess of \$500,000. This bill is scheduled to be heard in the Assembly Revenue and Taxation Committee on May 16, 2011.

Appendix A contains a legislative history of PIT and AMT rate change legislation.

## **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<sup>1</sup> 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 from 3 percent to 5 percent for taxable years beginning and after January 1, 2011; the state does not impose an AMT.

*Massachusetts* has not changed their flat PIT of 5.3 percent; the state does not impose an AMT.

*Michigan* has reduced their flat PIT from 4.35 percent to 4.25 percent for taxable years beginning on or after October 1, 2011; the state does not impose an AMT.

*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; the state imposes a 6.4 percent AMT.

*New York* has a maximum tax bracket of \$500,000 for both single and joint filers, with a maximum rate of 8.97 percent; the state imposes a 6 percent AMT.

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<sup>1</sup> SB 169 (Alquist, Stats. 1991, Ch. 117)

## FISCAL IMPACT

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

## ECONOMIC IMPACT

Estimated Revenue Impact of AB 1239 AMT Increase for Taxable Years 1/1/2011-12/31/2016; PIT Rate Increases for Taxable Years 1/1/2012- 12/31/2016 Enactment Assumed After June 30, 2011 (\$ in Millions)				
2011-12	2012-13	2013-14	2014-15	2015-16
\$950	\$1,600	\$1,700	\$1,800	\$1,900

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: Some taxpayers may say that increasing personal income taxes and increasing the personal AMT rate are required to reduce the state's fiscal crisis.

Con: Some taxpayers may argue that increasing the tax burden on wealthy taxpayers may further depress the already sluggish California economy.

## 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.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 1239

AMENDMENT 1

On page 7, line 15, delete “(“ before “Notwithstanding”.

AMENDMENT 2

On page 8, line 9, insert before clause (iv), “(iv) For any taxable year beginning on or after January 1, 2011, and before January 1, 2012, 7 percent”.

AMENDMENT 3

On page 8, line 9, strikeout “(iv)” and insert “(v)”.

AMENDMENT 4

On page 8, line 9, strikeout “2011” and insert “2012”.

AMENDMENT 5

On page 8, line 11, strikeout “(v)” and insert “(vi)”.