Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Huber	Analyst:	Michelle Chan	Bill Number:	AB 1963
Related Bills:	See Legislative History	Telephone:	845-6805	Introduced Date:	February 23, 2012
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: PIT Rates & Standard Deduction Revision

SUMMARY

This bill would reduce the six personal income tax (PIT) rates into two rates of 2.75 percent and 6.5 percent and would increase the standard deduction.

This analysis does not address the provisions of the bill related to sales and use tax rates as they do not impact the department nor state income tax revenue.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to diversify and stabilize the state tax revenue so that state tax revenues are less subject to volatile fluctuations.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. The PIT rate change provision would be specifically operative for taxable years beginning on or after January 1, 2013. The standard deduction increase would be operative for taxable years beginning on or after January 1, 2012.

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 imposes six different rates under the Personal Income Tax Law (PITL) ranging from 1 percent to 9.3 percent. Each tax rate applies to different ranges of income, known as “tax brackets.” Current state tax law requires the Franchise Tax Board (FTB) to recalculate the tax brackets each year based on the change in the California Consumer Price Index (CCPI).

Board Position:			Executive Officer	Date
________ S	________ NA	___X___ NP		
________ SA	________ O	________ NAR	Selvi Stanislaus	07/18/12
________ N	________ OUA			

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.

Existing federal and state laws allow taxpayers who do not elect to itemize their deductions for the taxable year to deduct from adjusted gross income a basic standard deduction amount in calculating their taxable income.

Both federal and state laws provide annual inflation indexing of the standard deduction. For the 2011 tax year, the state standard deduction for single or married filing separate taxpayers is $3,769 and is $7,538 for married filing joint, head of household, or qualifying widow(er).

The alternative minimum tax (AMT) was established to ensure that taxpayers that use preferential tax benefits do not completely escape taxation.

Federal tax 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. Existing state tax law provides an AMT rate of 7 percent for PIT taxpayers.

THIS BILL

This bill would reduce the six PIT rates into two rates of 2.75 percent and 6.5 percent and would increase the PIT standard deduction; for single or married filing separate the standard deduction would be $22,500 and for married filing joint, head of household or qualifying widow(er) the standard deduction would be $45,000.

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 would reduce the state's PIT rates into two new rates for taxable years beginning on or after January 1, 2013; however, the bill fails to provide a specified operative date for the provisions that would increase the standard deduction. Absent a specified operative date, the increase to the standard deduction would apply to taxable years beginning on or after January 1, 2012, which may be contrary to the author's intent. The author may wish to add language that would specify an operative date for the standard deduction increase.

This bill would also revise the indexing date for the changes in PIT rates; however, the bill fails to amend or revise the indexing date for the change to the standard deduction. Absent a revised indexing date, the increase to the standard deduction under this bill would be indexed for inflation going back to January 1, 1988, which may also be contrary to the author's intent. The author may wish to add language that would revise or amend the indexing date for the standard deduction increase.

LEGISLATIVE HISTORY

SB 13 (Hollingsworth, 2009/2010) would have incrementally reduced the PIT rate to zero over a five year period and would have eliminated the AMT at the end of the five year period and would have eliminated the MHT upon voter approval. SB 13 failed to passage in the Senate Revenue and Taxation Committee.

SB 57 (Hollingsworth, 2007/2008) would have incrementally reduced the PIT rate to zero by 2011, would have eliminated the AMT as of January 1, 2011, and would have eliminated the MHT upon voter approval. SB 57 failed to pass out of the Senate Revenue & Taxation Committee by the constitutional deadline.

SB 330 (Morrow, 2003/2004) and SB 1526 (Monteith, 1997/1998) would have doubled the amount of the standard deduction. SB 330 and SB 1526 both failed to pass out of the Senate Revenue & Taxation Committee.

AB 17 (Hollingsworth, 2001/2002) would have incrementally reduced the PIT rate to zero by 2005 and eliminated the AMT beginning in 2005. AB 17 failed passage in the Senate Revenue and Taxation Committee.

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 and after January 1, 2011; the state does not allow a standard deduction.

Massachusetts has a flat PIT rate of 5.3 percent; the state does not allow a standard deduction.

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; the state does not allow a standard deduction.

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 does not allow a standard deduction.

New York has a maximum tax bracket of $500,000 for both single and joint filers, with a maximum tax rate of 8.97 percent; for the 2011 tax year, the state standard deduction is $7,500 for single or married filing separate filers, $10,500 for head of household filers, and $15,000 for married filing joint and surviving spouse filers.

FISCAL IMPACT

This bill would require the FTB to revise the tax forms, instructions, and booklets. As a result, this bill could impact the department's printing and processing costs for tax returns.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents**:** Some may say that decreasing the personal income taxes and increasing the standard deduction are required to stabilize state revenue and reduce the state's fiscal crisis.

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

POLICY CONCERNS

Because this bill would reduce regular PIT rates incrementally without making a corresponding reduction in the AMT rate, this bill could increase the number of taxpayers who would owe AMT beginning taxable year 2013.

LEGISLATIVE STAFF CONTACT

Michelle Chan	Gail Hall
Legislative Analyst, FTB	Legislative Director, FTB
(916) 845-6805	(916) 845-6333
michelle.chan@ftb.ca.gov	gail.hall@ftb.ca.gov