Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Steinberg	Analyst:	William Koch	Bill Number:	SB 653
Related Bills:	See Legislative History	Telephone:	845-4372	Introduced Date: Amended Date:	February 18, 2011 April 14, 2011
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: FTB Administer Local Personal Income Tax

SUMMARY

This bill would authorize the board of supervisors of any county or city and county (hereinafter "county"), subject to voter approval, to impose, increase, or extend any of the following:

- A personal income tax.
- A transactions and use tax.
- A vehicle license fee (VLF).
- An excise tax, including but not limited to, a local alcoholic and sweetened beverage tax, a local cigarette and tobacco products tax, and a local medical marijuana tax.
- An extractive business activities tax.
- An oil severance tax.

This analysis focuses on the local personal income tax provision of the bill as it is the only provision that would be administered by the Franchise Tax Board (FTB).

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

Summary of Amendments

This bill as introduced February 18, 2011, contained spot bill language relating to general authorization for a local personal and corporate income tax, and a local sales and use tax. The April 14, 2011, amendments deleted the spot bill language and added the provisions identified above in the “Summary” section.

This is the department’s first analysis of this bill.

PURPOSE OF THE BILL

According to the author’s office, the purpose of this bill is to give counties the tools to raise funds if county elected officials and voters decide that revenues should be part of local budget solutions.

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EFFECTIVE/OPERATIVE DATE

This bill would be effective on January 1, 2012, and would be specifically operative for taxable years beginning on or after January 1 of the first calendar year following local voter approval, contingent upon the county elections official providing notice by September 30 of the preceding calendar year of the passage of the ordinance.

ANALYSIS

STATE LAW

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. For taxable years beginning on or after January 1, 2009, and before January 1, 2011, the tax for individuals is computed on a graduated scale at rates ranging from 1.25 percent to 9.55 percent. For taxable years beginning on or after January 1, 2011, the rates range from 1 percent to 9.3 percent. Current state law also imposes an additional 1 percent Mental Health Services tax, not subject to reduction by credits, on the portion of a taxpayer’s taxable income that exceeds $1 million.

Existing state law allows individuals to deduct certain expenses, such as medical expenses, charitable contributions, mortgage interest, and certain state or local taxes paid as itemized deductions. A VLF imposed by a state or local entity is considered a personal property tax that can be deductible as an itemized deduction.

Current state law generally allows business entities to deduct all expenses that are considered ordinary and necessary in conducting that trade or business. State and local taxes are deductible as a business expense except for taxes measured by income or profits.

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, subject to voter approval, to impose, increase, or extend a local personal income tax on county residents that would be administered by the FTB.

The bill would authorize the local personal income tax with the following provisions:

- The local personal income tax imposed on a county resident may not exceed one percent of the taxable income shown on the state personal income tax return and must be approved by the voters of that county. The local personal income tax imposed would be treated as though it were imposed under the same statutes as the state income tax and may be imposed on one or more of the state income tax brackets.

- Amounts paid for local personal income tax may not be deducted from the taxpayer's income for purposes of the state income tax, and no state income tax credits would be applicable to reduce the local personal income taxes imposed.

- The county would be required to enter into an agreement with the FTB to perform all functions incident to the administration of the local personal income tax, including a provision that the county would reimburse the FTB for all refunds, losses, and costs incurred in the administration and operation of the local personal income tax.

- The ordinance authorized to impose a local personal income tax would become operative for taxable years beginning on or after January 1 of the first calendar year following approval by the voters of the county if the county elections official provides notice of the voter approval no later than September 30 of the preceding calendar year of the passage of the ordinance by voters.

- The bill would authorize the FTB to use any information sources or enforcement remedies available to the county in addition to the information sources and remedies available to the FTB for administering the state income tax.

- FTB would be authorized to adopt regulations as necessary to administer the provisions of the bill.

- Local personal income tax amounts collected by the FTB would be transmitted to the Treasurer and deposited in the State Treasury to the credit of the Local Personal Income Tax Account (LPITA) in the General Fund that would be created by this bill. The moneys in the LPITA would be continuously appropriated, regardless of fiscal year, to the Controller for allocation to each county for which the local personal income tax is imposed.

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 bill would make the operative date of the bill for taxable years beginning on or after January 1 of the first calendar year following approval by the voters, conditioned on the county elections official providing notice no later than September 30 of the preceding year. The bill is silent regarding who is to receive notice from the county. It is recommended that the author specify that notice of a voter approved local personal income tax would be required to be provided to the FTB.

Additionally, because the bill does not provide an exception to the Administrative Procedures Act requirements, the operative date specified in the bill does not provide adequate time for the FTB to adopt regulations on all facets of administering and collecting a local personal income tax. It is recommended that the operative date be revised to be January 1 of the second calendar year after the enactment of the ordinance by voters to provide adequate time to complete the regulatory process.

The bill reimbursement structure would require the FTB to borrow funds from the General Fund programs it administers to implement and maintain the local personal income tax programs until the county can reimburse those amounts at a later date. The FTB lacks sufficient resources to fund the local personal income tax program for any period without putting at risk the core mission of state income tax administration. It is recommended that, consistent with the process in place between the Board of Equalization and local entities for local sales tax administration, the amounts transferred to the county be a net amount of funds collected reduced by the amount of costs, refunds, adjustments, or losses incurred by the FTB in administering the local personal income tax.

Additionally, while the bill would require the county to reimburse the department for costs incurred to implement and administer the local personal income tax, recent budget adjustments have impacted the department's ability to perform the work necessary to implement this bill. Even with reimbursement, additional position authority would be necessary to implement the bill without adversely impacting the department's existing General Fund revenue generating workload priorities.

Tax officials of political subdivisions of the State may obtain tax information from the FTB only upon affidavit. At the time the tax official requests the tax information, he or she must provide a copy of the affidavit to the taxpayer whose information is sought, and upon request, make the obtained information available to that person. If the author intends that the county tax officials receive information through a different process, express authorization for the FTB to provide information relative to the local personal income tax reported, paid, or collected would need to be authorized under the bill.

The bill lacks administrative details that must be determined to implement the bill and determine its impacts to the department's systems, forms, and processes. The bill is silent on the following issues:

- Payment priority between state income tax and use tax reported on the return, which are both sources of General Fund revenues, and the local personal income tax.
- The treatment of taxpayers filing jointly that do not both reside in the county that has imposed the income tax.
- Because of California residents' mobility, how would residency in a county be determined?
- Would wage withholding of amounts estimated to cover the local personal income tax be required? Would estimate tax payments be required? Would revisions to the Unemployment Insurance Code and withholding table requirements be needed?
- Because the county of residence is unknown, how would nonfiler enforcement efforts be applied?

It is recommended that the bill be amended to specify these conditions so that there is no confusion as to the author's intentions.

The FTB lacks the resources to identify taxpayers by county of residence and would need to rely on taxpayers self declaring their residency on their state income tax return. In cases where a taxpayer is subject to a local personal income tax and fails to file a state income tax return, the department lacks the data to identify the county of residence with certainty because most income data received by the department reflects the taxpayer's mailing address, which may not be in the same county as the taxpayer's county of residence. Calculating an estimated local personal income tax liability based on a taxpayer's "last known address" could result in inaccurate amounts being remitted to the affected counties.

Because not all counties would enact a local personal income tax immediately, the first county to enact the tax would incur the entire cost for implementation while counties that enact the tax at a later date would not be charged the startup costs paid by the earlier enacting county. To prevent disputes between counties and the department, it is recommended that the author specify how costs should be allocated among the counties that enact a county income tax.

LEGISLATIVE HISTORY

AB 1342 (Evans, 2009/2010) would have authorized the board of supervisors of any county to place on a ballot by ordinance, subject to voter approval, provisions to impose a local personal income tax and or a local VLF. This bill was held in the Assembly Revenue and Taxation Committee.

SB 10 (Leno, 2009/2010) would have required 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 VLF. This bill failed to pass out of the Assembly.

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 VLF 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.

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.

AB 1187 (Leno, 2003/2004) would have permitted the City and County of San Francisco to impose, upon voter approval, a local VLF. 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 the 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 any county board of education to impose 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 local income tax.

The above states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved but are anticipated to be significant.

ECONOMIC IMPACT

<u>Revenue Discussion</u>

The revenue impact of this bill depends on the amount of additional taxes approved by each county and reported on income tax returns as personal itemized or business expense deductions. Because the bill's new county-level tax assessments would require county board of supervisor and voter approval in each county to become law, the revenue impact of this bill is unknown.

Using the VLF as an example, the bill would allow an increase to the VLF of up to 1.35 percent. If all counties elected to impose the maximum additional VLF assessment, the resulting revenue losses to the state from the higher deductions would total approximately $150 million annually.

Given the local approval requirements, it is assumed the earliest counties could impose a local assessment under this bill is July 1, 2013. Based on this assumption, the proposed local assessment would be deductible on the 2013 tax returns, to be filed during 2014.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Pro: Proponents could argue that placing the option to increase taxes in the hands of local government allows the citizens to determine the priority and importance of local services that would be funded by the additional taxes.

Con: Opponents could argue that it is inequitable to assess taxes on county residents when nonresidents may also benefit from those services that would be funded by the additional taxes.

POLICY CONCERNS

While this bill would provide a mechanism for counties to increase revenue, it would do so at the expense of the state's General Fund due to the personal itemized and business expense deductibility of the various local taxes this bill would allow.

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