Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Cannella, et al. Analyst: David Scott Bill Number: SCA14

Related Bills: See Legislative History Telephone: 845-5806 Introduced Date: June 28, 2011

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Expenditure Limit/Budget Stabilization Fund & Supplemental Budget Stabilization Account/Unanticipated Revenues Shall Be Returned To Taxpayers Within Current Or Immediately Following Fiscal Year By One-Time Revision Of Tax Rates Or Rebates

SUMMARY

This measure would repeal Article XIIIB of the Constitution, which provides for returning one-half of any revenues in excess of allowable appropriations to taxpayers by a revision in the tax rates or fee schedules within the two fiscal years immediately succeeding the excess revenues. This measure adds Section 21 to Article XVI of the Constitution, which includes an option to allow the return to taxpayers, within the current or following fiscal year, unanticipated revenues by a one-time revision of tax rates or by rebates, after the Budget Stabilization Fund is funded.

This analysis will not address the measure’s changes to other provisions of the California Constitution regarding changing from “appropriation limits” to “expenditure limits”, funding level indexing, contribution levels, an itemized statement of state resources, or the Director of Finance report to the Governor as they do not impact the department or state income tax revenue.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

PURPOSE OF THE BILL

The purpose of this measure appears to be to strengthen the state’s “rainy day” fund and modify the existing appropriations limit.

EFFECTIVE/OPERATIVE DATE

As a constitutional amendment, the measure must be submitted to and approved by the voters at a statewide election. It would be effective the day after the election and operative as of that date unless the measure provides otherwise.

Board Position:			Executive Officer	Date
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ANALYSIS

STATE LAW

Under the current Constitution, the Governor is required to submit a budget for the ensuing fiscal year to the Legislature within the first ten days of each calendar year. The budget is required to include an itemized statement for recommended state expenditures and estimated state revenues. Each year three percent of the estimated General Fund revenue is required to be transferred by the Controller to the Budget Stabilization Account. Fifty percent of the amount transferred, up to $5 billion, shall be deposited into the Deficit Recovery Bond Retirement Sinking Fund subaccount.

Article XIIIB establishes an appropriations limit on state and local spending. Half of the proceeds of taxes that are in excess of this appropriation limit averaged over a two-year period must be returned by a revision of tax rates or fee schedules and half must be allocated for schools.

THIS MEASURE

This measure would provide that unanticipated revenues in excess of appropriations be used in the following order:

- Payment of General Fund obligations to schools;
- Transfers to the Budget Stabilization Fund until the fund is 10 percent of estimated General Fund revenues;
- Payment of budgetary obligations; then
- Any of the following:
    - Return of excess unanticipated revenues to taxpayers through a one-time change in tax rates, or by rebates;
    - Transfers to the Budget Stabilization Fund;
    - Appropriations to retire, redeem, or defease outstanding bond indebtedness of the State;
    - Appropriations for one-time infrastructure or other capital outlay purposes; or
    - Appropriations for unfunded liabilities for vested nonpension benefits for state annuitants.

IMPLEMENTATION CONSIDERATIONS

The Revenue and Taxation Code requires the Franchise Tax Board (FTB) to administer and enforce the income and franchise tax laws. This constitutional amendment presumably would require the FTB to oversee the issuance of rebates, if rebates of income and/or franchise tax were the selected method to refund unanticipated excess revenues.

Department staff has identified the following implementation considerations for purposes of a high level discussion; additional concerns may be identified as the measure moves through the legislative process. In order for the FTB to implement this measure, clarification is necessary for the following issues:

- Provisions of the Internal Revenue Code require reporting of state or local personal income tax refunds to the Internal Revenue Service (IRS). If the rebate is considered a refund of income taxes paid, it would be required to be reported to the IRS and may be subject to federal income taxes. The department would have to make computer system changes to account for and track rebates for reporting purposes because the reporting volume would increase to include all individual taxpayers that paid tax.
- Currently, the FTB, IRS, and other state agencies participate in an offset process where refunds are applied to satisfy an outstanding liability owed by the taxpayer to another government entity. The rebate could be construed as either a payment of excess state revenues or a refund of taxes paid. As such, clarification would be needed on whether these payments would be subject to the agency-offset process or could be offset against a taxpayer's unpaid income tax liabilities for other years.
- In order for the FTB to administer any rebate or tax rate change with respect to income/franchise taxes, rules and guidance would have to be provided on:
- How to compute the tax rate change;
- How to calculate the amount of a rebate given;
- Which taxpayers would receive the rebate; and
- How taxpayers would receive the rebate.

If these concerns, and additional concerns that may be identified, are not clarified in this measure, then the department would need implementation language prior to the issuance of the rebates or making any rate changes. Without implementation details, the FTB would be unable to implement the rebate or rate reduction provisions of this measure.

In addition, if the FTB were responsible for issuing the rebates proposed by this measure, the department would need to create a new system and modify existing accounting and collection systems for issuing and processing the rebates. This measure does not include an appropriation to cover the costs of developing new and modifying existing systems for issuing and processing the rebate. Without an appropriation, the department would be required to redirect resources from revenue producing activities to implement this measure

LEGISLATIVE HISTORY

SCA 10 (Strickland, et al, 2011/2012) proposes a constitutional amendment that would require a portion of revenues in excess of the amount that may be deposited into the reserve account to be rebated to personal income tax (PIT) taxpayers. This measure is currently in the Senate Governance and Finance Committee.

ACA 4 (Stats. 2010, Res. Ch. 174) and SCA 10 (Ashburn, et al., 2009/2010) were essentially the same. Both sought to propose a constitutional amendment that would provide for the prioritized use of state revenue in excess of appropriations, including the return of excess unanticipated revenues to taxpayers through a one-time change in tax rates or by rebates. ACA 4 was chaptered and the proposed constitutional amendment will be placed before the voters for approval. SCA 10 failed to pass out of the Senate by the constitutional deadline.

SCA 33 (Wyland, 2009/2010) proposed a constitutional amendment that would require a portion of revenues in excess of the amount that may be deposited into the reserve account to be rebated to PIT taxpayers. SCA 33 failed to pass by the constitutional deadline.

Proposition 1A (2009) would have required any annual state revenue increase that was above "historic trends," plus an increase for the rate of inflation and population growth, up to a maximum of three percent of annual revenues, to be deposited into the state budget stabilization fund (BSF or "rainy day fund") each year until the fund reached an increased target balance equal to 12.5 percent of the state general fund; however, even if there were a revenue increase, BSF deposits would only have occurred once education spending levels mandated by Proposition 98 (1988) had been attained. The proposition did not pass.

The following measures were essentially the same. ACA 34 (Anderson, 2009/2010- never heard in committee), ACA 6 (Campbell, 2003/2004- passed out of committee without further action), ACAX5 4 (Keene, 2003/2004 - passed out of committee without further action.) These measures would have limited the state's expenditure increases to no more than the increase in the cost of living, as specified, multiplied by the percentage increase in state population. These measures also provided that 50 percent of the excess revenues must be returned to the taxpayer by revising the tax rates and fee schedules within the next two fiscal years.

ACA 3 (Gaines, 2007/2008) would have limited the state's expenditure increases to no more than the increase in the cost of living, as specified, multiplied by the percentage increase in state population and provided that 50 percent of excess revenues for the fiscal year went to the State School Fund and the other 50 percent be divided equally between the reserve account, taxpayer rebates, and to fund health benefits of state and California State University employees. The measure failed to pass by the Constitutional deadline.

SCAX5 2 (Ashburn, 2003/2004) created a Budget Stabilization Fund and provided that excess revenues could provide rebates to taxpayers of California. The measure failed to pass by the Constitutional deadline.

OTHER STATES' INFORMATION

A National Conference on State Legislation article[1] on state stabilization funds stated that as of September 2008, forty-seven states, the District of Columbia, Puerto Rico, and the U.S Virgin Islands had established budget stabilization funds commonly referred to as "rainy day" funds.

[1] Daniel G. Thatcher, "State Budget Stabilization Funds", National Conference of State Legislatures, September 26, 2008.

State budget stabilization funds are created either through statutory or constitutional authorization. While most states' budget stabilization funds are statutorily created, 11 states (*Alabama, Alaska, Delaware, Louisiana, Missouri, Oklahoma, Oregon, South Carolina, Texas, Virginia and Washington*) have constitutionally authorized funds. Five states (*Alabama, Alaska, California, Oregon and South Carolina*) have one statutorily and one constitutionally authorized budget stabilization fund.

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*, which has no personal income tax, requires excess revenues to be refunded to taxpayers.
- *Massachusetts* allows a credit, called the “excess revenue credit,” toward taxpayers’ personal income tax liabilities.
- *Michigan* requires excess revenue to be refunded on a pro rata basis that is based on the liability reported on the Michigan income tax and single business tax returns.

A review of *Minnesota*, *New York* and *Illinois* state laws and constitutions did not produce any information regarding procedures for state revenues in excess of appropriations.

FISCAL IMPACT

Depending on the level of responsibility given to the department, costs could be significant. At a minimum, the department would need to implement a system to calculate, issue, and track the rebates proposed in this measure. In addition, the department could be required to reissue rebates returned as undeliverable or deposited into escheat, comply with additional revenue reporting requirements for rebates, and report on rebates within the offset program. It is likely that the department would receive a significant number of additional phone calls and visits to field offices from taxpayers inquiring about the rebates.

The additional costs cannot be determined at this time, but are estimated to be significant.

ECONOMIC IMPACT

Revenue Discussion

This measure would not alter the calculation of personal or corporation income taxes.

There is a potential indirect impact to the General Fund should a there be a one-time change in tax rate or a rebate to taxpayers. However, to determine the magnitude of this potential refund on the General Fund, both the frequency with which the state realizes a surplus and the dollar amount of those funds must be known. Since it is difficult to predict the frequency and the value, the revenue impact on the General Fund is unknown.

SUPPORT/OPPOSITION

Support: None identified to date.

Opposition: None identified to date.

ARGUMENTS

Pro: Those in favor of this measure might argue that taxpayer dollars in excess of program needs and a reserve fund should be returned to the taxpayers.

Con: Those opposed to this measure might argue that the existing appropriations limit and Budget Stabilization Account are sufficient.

LEGISLATIVE STAFF CONTACT

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