

## ANALYSIS OF AMENDED BILL

Author: Eggman, et al. Analyst: Davi Milam Bill Number: AB 1356  
Related Bills: See Legislative History Telephone: 845-2551 Amended Dates: April 3 & April 6, 2017  
Attorney: Bruce Langston Sponsor: \_\_\_\_\_

**SUBJECT:** Higher Education Assistance Fund/ Impose Additional 1 Percent Tax on Taxable Income in Excess of \$1 Million

### SUMMARY

This bill would, under the Education Code, create the Higher Education Assistance Fund, and under the Personal Income Tax Law (PITL), create an additional 1 percent tax on taxable income in excess of \$1 million.

This analysis only addresses the provisions of the bill that would impact the department's programs and operations.

### RECOMMENDATION – NO POSITION

#### Summary of Amendments

The April 3, 2017, amendments added coauthors and removed the bill's provisions that would have made nonsubstantive changes to the Government Code, and replaced them with the provisions discussed in this analysis.

The April 6, 2017, amendments added authors and coauthors, modified the operative date, and made other technical changes.

This is the department's first analysis of the bill.

### REASON FOR THE BILL

The reason for this bill is to provide funding of student financial assistance for in-state, undergraduate students enrolled at the University of California, the California State University, and the California Community Colleges.

### EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2018, and would only become operative if Assembly Constitutional Amendment (ACA) 13 of the 2017-18 Regular Session is approved by the voters, and the additional tax would then be specifically operative for taxable years beginning on or after January 1, 2019.

ACA 13, as a constitutional amendment, would become effective the day following approval by the voters in the next general election following approval of the measure by the Legislature.

## **FEDERAL/STATE LAW**

Federal tax law imposes seven different personal income tax rates on individuals ranging from 10 percent to 39.6 percent.

State tax law imposes nine different rates under the PITL:

- Six permanent rates ranging from 1 percent to 9.3 percent, and
- Three temporary rates – 10.3 percent, 11.3 percent, and 12.3 percent.<sup>1</sup>

Each tax rate applies to different ranges of income, known as “tax brackets.” Current state law requires the Franchise Tax Board (FTB) to adjust the tax brackets each year based on the change in the California Consumer Price Index (CCPI).

Current state law also imposes an additional 1 percent Mental Health Tax (MHT) on the portion of a PITL taxpayer’s taxable income that exceeds \$1 million. The MHT may not be reduced by any credits and the taxable income threshold of \$1 million is not subject to indexing. The MHT is subject to estimated tax payment requirements, interest, penalty, and other tax administration rules applicable to taxes imposed under the PITL.

## **THIS BILL**

For each taxable year beginning on or after January 1, 2019, this bill would, under the PITL, impose an additional tax at the rate of 1 percent on that portion of a taxpayer’s taxable income in excess of \$1 million (\$1,000,000).

The tax imposed under this bill would not be reduced by any tax credits and the taxable income threshold of \$1 million would not be subject to indexing. The tax would be subject to estimated tax payment requirements, interest, penalty, and other tax administration rules applicable to taxes imposed under the PITL.

This bill would, under the Education Code, create the Higher Education Assistance Fund in the State Treasury that would receive all revenues, net of refunds, from the additional tax that would be imposed by this bill. The Higher Education Assistance Fund would be continuously appropriated to the Controller for funding of student financial assistance for tuition and fees required for in-state, undergraduate students, enrolled at the University of California, the California State University, and the California Community Colleges.

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<sup>1</sup> Under Proposition 30, the three high-income rates are operative for taxable years beginning on or after January 1, 2012, and before January 1, 2019. Proposition 55 extended the operative period to taxable years beginning before January 1, 2031.

## **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.

This bill fails to specify a transfer schedule or funding mechanism to address how and when the revenue generated from this additional tax would be identified and transferred from the state's General Fund to the Higher Education Assistance Fund. Absent a transfer schedule or funding mechanism, it is unclear how the department would identify the amount of revenue attributable to the additional tax imposed by this bill and the timing of transfers of the revenue to the Higher Education Assistance Fund. To facilitate the FTB's administration of this bill, the author may wish to consider the provisions of Revenue and Taxation Code section 19602.5, enacted as a result of Proposition 63, which provides estimates of revenue and a detailed calculation and transfer rate of the MHT.

## **LEGISLATIVE HISTORY**

AB 462 (Price, 2009/2010) would have imposed an additional 1 percent tax on taxable income in excess of \$1 million to offset the increased education costs at the University of California and the California State University. AB 462 failed to pass out of the Assembly by the constitutional deadline.

AB 2372 (Coto, 2007/2008), identical to AB 462, would have imposed an additional 1 percent tax on taxable income in excess of \$1 million. AB 2372 failed to pass out of the Assembly by the constitutional deadline.

## **OTHER STATES' INFORMATION**

The states surveyed include *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.

*Illinois*, *Massachusetts*, and *Michigan* impose a flat PITL rate of 3.75 percent, 5.1 percent, and 4.25 percent, respectively.

*Minnesota* has four PITL tax rates ranging from 5.35 percent to 9.85 percent. The maximum rate applies to income over \$155,650 for single and over \$259,421 for joint filers.

*New York* has eight PITL tax rates ranging from 4 percent to 8.82 percent. The maximum tax rate applies to income over \$1,070,350 for single filers and income over \$2,140,900 for joint filers.

## **FISCAL IMPACT**

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process and the implementation considerations are resolved, costs will be identified and an appropriation will be requested, if necessary.

## ECONOMIC IMPACT

### Revenue Estimate

This bill would result in the following revenue gain:

Estimated Revenue Impact of AB 1356 As Amended on April 6, 2017 Assumed Enactment After June 30, 2017 (\$ in Billions)		
2017-18	2018-19	2019-20
\$0	+ \$1.1*	+ \$2.1*

\*Because this bill does not specify a transfer or funding mechanism, it is unclear whether this bill would impact the General Fund. If the implementation concerns are resolved, the revenue generated from this additional tax would be transferred from the state's General Fund to the Higher Education Assistance Fund and would have no impact on General Fund revenue.

This estimate assumes the ACA 13 is approved by the voters and becomes operative.

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

### Revenue Discussion

This bill would impose an additional tax at the rate of 1 percent on that portion of a taxpayer's taxable income in excess of \$1 million for personal income taxpayers. The additional tax proposed is similar to the MHT. Therefore, this estimate assumes the revenue impact would be comparable to the MHT. Because the income reported by high-income taxpayers is volatile, the revenue impact of taxes imposed on these taxpayers can vary considerably from year to year.

Based on the Governor's Budget Summary for 2017-18, the estimated revenue from the MHT would be approximately \$1.9 billion for fiscal year 2017-18. Using this amount as a baseline and taking into account the operative date of January 1, 2019, it is assumed the revenue from this bill for fiscal year 2018-19 would be approximately \$1.1 billion and \$2.1 billion for fiscal year 2019-20.

### SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

## **ARGUMENTS**

Proponents: Some may say that this bill would provide critical funding for higher education.

Opponents: Some could argue the additional tax that this bill would raise, after Proposition 55's extension of the three top rates on high-income taxpayers through 2030, is inconsistent with the State's improved fiscal outlook.

## **POLICY CONCERNS**

Taxpayers subject to tax under the PITL who have taxable income in excess of \$1 million are currently subject to the 1 percent MHT. The provisions of this bill would subject the same income to an additional 1 percent tax.

Funding based on additional taxes imposed on high-income taxpayers creates uncertainty because the amount of income reported by high income taxpayers is volatile.

## **LEGISLATIVE STAFF CONTACT**

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