Analysis of Amended Bill

Subject: Federal Income Tax Paid Deduction

Summary

This bill would, under the Personal Income Tax Law (PITL), allow a deduction for an individual taxpayer equal to the amount of federal tax paid in the same taxable year.

Recommendation – No position.

Summary of Amendments

The February 27, 2018 amendments made technical corrections to the bill. This is the department’s first analysis of the bill.

Reason for the Bill

The reason for the bill is to provide some relief from state taxes paid by offering a deduction on the amount of federal taxes paid in the same year.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2018.

Federal/State Law

Federal law generally allows a non-business deduction on an individual taxpayer's federal return for state and local taxes paid. The recent enactment of federal Public Law 115-97, among other things, limits the state and local taxes deduction to $10,000 for taxable years beginning on or after January 1, 2018, and before January 1, 2026.

State law lacks a comparable deduction.

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1 Otherwise known as the Tax Cuts and Jobs Act of 2017.
This Bill

For taxable years beginning on or after January 1, 2018, this bill would provide a deduction equal to the amount of federal income tax paid by an individual for that taxable year.

“Federal income tax paid” means the amount paid to the Internal Revenue Code (IRC) for the individual’s federal income tax liability\(^2\) after reduction for all credits allowed\(^3\) for that taxable year, except for the credit for payments of federal estimated tax, the credit for the overpayment of any federal tax, and the credit allowed by Section 31.\(^4\)

Any additional federal income tax paid by an individual on income for the individual’s federal tax liability for that taxable year, beginning on or after January 1, 2018, that may be assessed for federal income tax\(^5\) after the filing of the original return shall be allowed as a deduction for the taxable year in which the amount is paid.

Any refund or credit of federal income tax previously paid by an individual for a taxable year beginning on or after January 1, 2018, that is received or credited after the filing of the original return by the individual for which the individual was previously allowed as a deduction, shall be included as income for the taxable year which the refund is received.

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.

Legislative History

SB 227 (De Leon, et al, 2017/2018) would create the “California Excellence Fund” and provide taxpayers that contribute to this fund a tax credit. SB 227 is currently in the Senate.

Other States’ Information

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not provide a deduction comparable to the deduction allowed by this bill. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

Fiscal Impact

The department’s costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

\(^2\) Under Chapter 1 of the IRC.
\(^3\) Ibid.
\(^4\) Of the IRC, relating to taxes withheld on wages.
\(^5\) Under Chapter 1 of the IRC.
**Economic Impact**

**Revenue Estimate**

This bill would result in the following revenue loss:

**Estimated Revenue Impact of AB 1864 as Amended February 27, 2018**
For Taxable Years Beginning On or After January 1, 2018
Assumed Enactment after June 30, 2018

($ in Billions)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018-2019</td>
<td>- $27</td>
</tr>
<tr>
<td>2019-2020</td>
<td>- $18</td>
</tr>
<tr>
<td>2020-2021</td>
<td>- $19</td>
</tr>
</tbody>
</table>

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Revenue Discussion**

Based on output from the Franchise Tax Board's Personal Income Tax micro-simulation model, it is estimated that in the 2018 taxable year, a state miscellaneous itemized deduction for federal taxes paid subject to the two percent floor would result in an $18 billion revenue loss.

The tax-year estimates are converted to fiscal years, then rounded to arrive at the figures in the above table.

**Support/Opposition**

Support: None provided.

Opposition: None provided.
Arguments

Proponents: Some may argue that with the new state and local tax deduction limitation at the federal level, California’s individual taxpayers should be afforded an additional deduction to help reduce their overall state income tax liability.

Opponents: Some may argue that the economic impact of this proposal far outweighs the benefit to taxpayers.

Policy Concerns

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a tax benefit by the Legislature.

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