



## Analysis of Amended Bill

Author: Fong, et al.                      Sponsor:                      Bill Number: AB 1922  
Analyst: Janet Jennings              Phone: (916) 845-3495              Introduced January 24, 2018, and  
Attorney: Bruce Langston              Related Bills: See Legislative              Amended March 1, 2018  
History

**Subject:** PIT Rates/Modify All Rates/Increase Renter's Credit & Homeowner's Property Tax Exemption/Eliminate Minimum Franchise Tax/California Competitiveness Act

### Summary

This bill would do the following:

- Provision 1: Increase the homeowner's property tax exemption.
- Provision 2: Modify the personal income tax (PIT) rates and brackets.
- Provision 3: Increase the amount of the Renter's Credit.
- Provision 4: Eliminate the minimum franchise tax.

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

**Recommendation – No position.**

### Economic Impact – Summary Revenue Table

(\$ in Millions)

Fiscal Year	2018-2019	2019-2020	2020-2021
Provision 1: Increase the homeowner's property tax exemption	0	+ \$12	+ \$25
Provision 2: Modify the personal income tax (PIT) rates and brackets	- \$19,000	- \$12,000	- \$13,000
Provision 3: Increase the amount of the Renter's Credit	0	- \$110	- \$120
Provision 4: Eliminate the minimum franchise tax	- \$1,600	- \$1,200	- \$1,300
Total	- \$20,600	- \$13,298	- \$14,395

## **Summary of Amendments**

The bill as introduced January 24, 2018, would increase the homeowner's property tax exemption, modify the PIT rates and brackets, increase the amount of the Renter's Credit, and eliminate the minimum franchise tax. The March 1, 2018, amendments added coauthors, modified the PIT rates and brackets, and removed a minimum franchise tax reference.

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

## **Reason for the Bill**

The purpose of the bill is to make California competitive with other states, especially for California's families and small businesses.

## **Provision 1: Increase the Homeowner's Property Tax Exemption**

### **Effective/Operative Date**

As a tax levy, this provision would be effective immediately and operative beginning with the lien date for the 2019-2020 fiscal year.

### **Federal/State Law**

California generally conforms to federal law and allows real estate taxes as an itemized deduction.<sup>1</sup> An itemized deduction is an eligible expense that individual taxpayers can report on their tax return in order to decrease their taxable income.

Current state law requires a taxpayer who owns real estate not used for business to be assessed a tax on that property at a specified percentage. The county where the property is located generally assesses this tax. The first \$7,000 of the full value of a homeowners' dwelling is exempt from that property tax.

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<sup>1</sup> The federal Tax Cuts and Jobs Act, enacted December 22, 2017, provides that an individual may claim an itemized deduction of up to \$10,000 (\$5,000 for married taxpayers filing a separate return) for the aggregate of (i) state and local property taxes not accrued in carrying on a trade or business, or an activity described in section 212, and (ii) state and local income, foreign, income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the taxable year. Individuals are also not allowed a deduction for foreign real property taxes. The above rules apply to taxable years beginning after December 31, 2017, and beginning before January 1, 2026.

### **This Provision**

This provision would increase the homeowner's property tax exemption from \$7,000 to \$14,000 beginning with the lien date for the 2019-2020 fiscal year; reducing the property tax paid for purposes of the income tax deduction.

### **Implementation Considerations**

Implementing this provision would not significantly impact the department's programs and operations.

### **Legislative History**

AB 1100 (Chen, et al., 2017/2018) would have increased the amount of the homeowner's property tax exemption and the Renter's Credit. AB 1100 failed to pass out of Assembly Appropriations Committee.

AB 476 (Chang, 2015/2016) would have increased the amount of the homeowner's property tax exemption and the Renter's Credit. AB 476 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 2694 (Lackey, et al., 2015/2016) would have increased the Renter's Credit and temporarily eliminated the adjusted gross income thresholds for 2016-2019. AB 2694 failed to pass out of the Assembly Appropriations Committee.

SB 1103 (Cannella, 2015/2016) would have increased the Renter's Credit. SB 1103 failed to pass out of the Senate Appropriations Committee.

SB 1216 (Morrell, 2013/2014) would have increased the amount of the homeowners' property tax exemption and increased the Renter's Credit. SB 1216 failed to pass out of the Senate by the constitutional deadline.

AB 2097 (Morrell, 2013/2014) would have increased the amount of the homeowners' property tax exemption and increased the Renter's Credit. AB 2097 failed to pass the Assembly Revenue and Taxation Committee.

### **Other States' Information**

Because this provision would increase the homeowner's property tax exemption, a review of other states' tax information would not be relevant.

### **Fiscal Impact**

This provision would not significantly impact the department's costs.

**Economic Impact**

<b>Fiscal Year (\$ in Millions)</b>	<b>2018-2019</b>	<b>2019-2020</b>	<b>2020-2021</b>
Provision 1: Increase the homeowner’s property tax exemption	0	+ \$12	+ \$25

Revenue Discussion

Based on 2017 data from the Board of Equalization, the increase in the homeowner’s exemption would result in an estimated property tax savings of approximately \$400 million for the 2017-2018 fiscal year. Based on this savings, the Franchise Tax Board (FTB) estimates that taxpayers itemizing their deductions would report \$370 million less in property taxes as itemized deductions on their California tax return, increasing their state taxable income. The estimate was then adjusted to reflect changes in the economy over time increasing the property tax deduction to \$380 million for fiscal year 2019-20. Applying a 6 percent tax rate would result in an estimated revenue gain of \$24 million for the fiscal year and \$12 million for taxable year 2019 and \$25 million for taxable year 2020.

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

**Support/Opposition**

Support: None provided.

Opposition: None provided.

**Arguments**

Proponents: Some could argue the increase in the homeowner’s property tax exemption is long overdue.

Opponents: Some could argue the increase in homeowner’s property tax exemption is not necessary.

**Provision 2: Modify PIT Rates and Brackets**

**Effective/Operative Date**

As a tax levy, this provision would be effective immediately and operative for taxable years beginning on and after January 1, 2018, and again for taxable years beginning on or after January 1, 2031.

## **Federal/State Law**

Federal law imposes different income tax rates on individuals using a graduated scale. For taxable year 2017, the tax rate starts at 10 percent and gradually increases to a top rate of 39.6 percent. For 2018, the top rate will fall from 39.6 percent to 37 percent. The bottom rate remains at 10 percent, but it covers roughly twice the amount of income compared to the previous brackets.

Existing state law imposes different PIT tax rates ranging from one percent to 12.3 percent.

Proposition 30, passed by a majority of California voters on November 6, 2012, added Section 36 to Article XIII of the California Constitution, which temporarily increases the top tax rate to 9.3 percent under Revenue and Taxation Code (R&TC) section 17041 for taxable years beginning on or after January 1, 2012, and before January 1, 2019.

Proposition 55, passed by a majority of California voters on November 8, 2016, extended the increase for taxable years beginning on or after January 1, 2019, and before January 1, 2031.

Under both of these propositions, the 9.3 percent tax rate is increased for taxpayers that have taxable income over \$250,000. The increased tax rates are 10.3 percent for the portion of taxable income that is over \$250,000 but not over \$300,000, 11.3 percent for the portion of taxable income that is over \$300,000 but not over \$500,000, and 12.3 percent for the portion of taxable income that is over \$500,000, recomputed under subdivision (h) of Section 17041 of the Revenue and Taxation Code.

Additionally, there is an additional tax of 1 percent on the portion of a taxpayer's taxable income that exceeds \$1,000,000.<sup>2</sup>

## **This Provision**

This provision would, for taxable years beginning on or after January 1, 2018, with the exception of those using the head of household filing status replace the PIT tables for California residents and part-year or non-residents leaving the additional tax rates imposed by Proposition 55, as described above, intact. For taxable years beginning on or after January 1, 2031, this provision would set the maximum tax rate at 8 percent.<sup>3</sup>

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<sup>2</sup> R&TC section 17043.

<sup>3</sup> The tables do not include the additional 1 percent tax under R&TC section 17043.

For California Residents

<b>If the taxable income is:</b>	<b>The tax is:</b>
Not over \$7,850	0% of the taxable income
Over \$7,850 but not over \$18,610	0% plus 1% of the excess over \$7,850
Over \$18,610 but not over \$29,372	\$107.60 plus 2% of the excess over \$18,610
Over \$29,372 but not over \$40,773	\$322.84 plus 4% of the excess over \$29,372
Over \$40,773 but not over \$51,530	\$787.28 plus 6% of the excess over \$40,733
Over \$51,530 but not over \$250,000	\$1,432.70 plus 8% of the excess over \$51,530

Taxable income more than \$250,000 and less than \$300,000 would be subject to a tax rate of 10.3 percent.\*

Taxable income more than \$300,000 and less than \$500,000, the tax rate is 11.3 percent.\*

Taxable income more than \$500,000, the tax rate is 12.3 percent.\*

\*Dollar amounts do not reflect indexing.

For Heads of Household, Taxable Years Beginning On or After January 1, 2031:

<b>If the taxable income is:</b>	<b>The tax is:</b>
Not over \$15,710	0% of the taxable income
Over \$15,710 but not over \$37,221	0% plus 1% of the excess over \$15,710
Over \$37,221 but not over \$47,982	\$215.11 plus 2% of the excess over \$37,221
Over \$47,982 but not over \$59,383	\$430.33 plus 4% of the excess over \$47,982
Over \$59,383 but not over \$70,142	\$886.37 plus 6% of the excess over \$59,383
Over \$70,142 but not over \$340,000	\$1531.91 plus 8% of the excess over \$70,142

### Implementation Considerations

Implementing this provision 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 1210 (Anderson, 2017/2018) would, for taxable years beginning on or after January 1, 2018, create an alternate tax table for taxable income of \$75,000 or less (\$100,000 or less for Head of Household) that would include a top rate of 8.8 percent. SB 1210 has been referred to the Senate Committee on Governance and Finance.

### 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* has a flat tax rate of 4.95 percent. *Massachusetts* has a split rate, a flat tax rate of 5.1 percent for most income. *Michigan* has a flat tax rate of 4.25 percent. *Minnesota* has a progressive rate with a maximum rate of 9.85 percent. *New York* has a progressive rate with a maximum rate of 8.82 percent.

### Fiscal Impact

The department's costs to implement this provision have yet to be determined. As the bill continues to move through the legislative process, costs will be identified.

### Economic Impact

Fiscal Year (\$ in Millions)	2018-2019	2019-2020	2020-2021
Provision 2: Modify the personal income tax (PIT) rates and brackets	- \$19,000	- \$12,000	- \$13,000

### Revenue Estimate

Using the FTB's micro-simulation model, the tax liability was recalculated using the tax brackets and rates specified in this bill. This results in a revenue loss of approximately \$12 billion in the 2018 taxable year.

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

## **Support/Opposition**

Support: None provided.

Opposition: None provided.

## **Arguments**

Proponents: Some may argue the reduction in the personal income tax rates would reduce the burden on lower income Californians.

Opponents: Some may argue that reducing the personal income tax rates reduces the state's ability to fund essential services.

## **Provision 3: Increase the amount of the Renter's Credit**

### **Effective/Operative Date**

As a tax levy, this provision would be effective immediately and operative for taxable years beginning on or after January 1, 2019.

### **State Law**

Current state law allows a nonrefundable income tax credit for qualified renters in the following amounts:

- \$60 for taxpayers filing single or married filing separate with an adjusted gross income (AGI) of \$40,078 or less, and
- \$120 for taxpayers filing married filing joint, head of household, or surviving spouse with an AGI of \$80,156 or less.

The California Constitution requires the Legislature to provide increases in benefits to qualified renters that are comparable to the average increase in benefits provided under the homeowner's property tax exemption.

### **This Provision**

This provision would, for taxable years on or after January 1, 2019, increase the amount of the Renter's Credit to \$120 for a qualified taxpayer using the single or married filing separate filing status and \$240 for a qualified taxpayer using married filing joint, surviving spouse, or head of household filing. The FTB would be required to annually adjust the amount of the Renter's Credit based on the change in the California Consumer Price Index for each taxable year beginning on or after January 1, 2020.

### **Implementation Consideration**

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.



## Legislative History

AB 1100 (Chen, 2017/2018) would have, contingent upon a specified appropriation, increased the amount of the homeowner's property tax exemption and modified the Renter's Credit. AB 1100 failed to pass out of the Assembly Appropriations Committee.

AB 476 (Chang, 2015/2016) would have increased the amount of the homeowner's property tax exemption and the Renter's Credit. AB 476 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 2694 (Lackey, et al., 2015/2016) would have increased the Renter's Credit and temporarily eliminated the applicable AGI thresholds. AB 2694 failed to pass out of the Assembly Appropriations Committee.

SB 1103 (Cannella, 2015/2016) would have increased the Renter's Credit. SB 1103 failed to pass out of the Senate Appropriations Committee.

AB 2097 (Morrell, 2013/2014) would have increased the amount of the homeowners' property tax exemption and the Renter's Credit. AB 2097 failed to pass out of the Assembly Revenue and Taxation Committee.

SB 1216 (Morrell, 2013/2014) would have increased the amount of the homeowner's property tax exemption and the Renter's Credit. SB 1216 failed to pass out of the Senate 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.

*Michigan* allows renters or lessees of homesteads to claim a credit based on 20 percent of the gross rent paid. A person who rents or leases a homestead that is subject to a service charge instead of property taxes, can claim a credit based on 10 percent of the gross rent paid. Only the renter or lessee can claim a credit on property that is rented or leased as a homestead. The maximum credit is \$1,200.

*New York* allows a real property tax credit for residents who have household gross income of \$18,000 or less and pay either real property taxes or rent for their residences. If all members of the household are under age 65, the maximum credit is \$75. If at least one member of the household is age 65 or older, the maximum credit is \$375.

*Illinois*, *Massachusetts*, and *Minnesota* do not have a comparable credit.

## Fiscal Impact

This provision would not significantly impact the department's costs.

**Economic Impact**

<b>Fiscal Year (\$ in Millions)</b>	<b>2018-2019</b>	<b>2019-2020</b>	<b>2020-2021</b>
Provision 3: Increase the amount of the Renter’s Credit	0	- \$110	- \$120

Based on data from the FTB’s Personal Income Tax micro-simulation model, the amount of the Renter’s Credit that taxpayers currently claim was recalculated using the proposed credit amounts, and then reduced by the amount currently claimed. The amount of additional credit each taxpayer could use would be limited by their current tax liability. As a result, the revenue loss from the increase in the available Renter’s Credit is estimated to be \$94 million in 2015. The estimate was then adjusted to reflect changes in the economy over time, resulting in an estimated revenue loss of \$110 million in 2019 and \$120 million in 2020.

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

**Support/Opposition**

Support: None provided.

Opposition: None provided.

**Arguments**

Proponents: Some may argue that increasing the Renter’s Credit would assist struggling taxpayers.

Opponents: Some may argue that increasing the Renter’s Credit would be burdensome on the General Fund.

**Provision 4: Eliminate the Minimum Franchise Tax (MFT)**

**Effective/Operative Date**

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

**State Law**

Under existing state law, unless specifically exempted by statute, every corporation organized, qualified to do business, or doing business in this state, whether organized in-state or out-of-state, is subject to the MFT. Corporate taxpayers must pay the MFT only if it is more than their measured franchise tax. In general, for taxable years beginning on or after January 1, 1997, only taxpayers subject to the Corporation Tax Law (CTL) with net income less than approximately \$9,040 pay the MFT because the amount of “measured” tax owed would be less than \$800 ( $\$9,039 \times 8.84\% = \$799$ ).

Real estate mortgage investment conduits (REMICs) are subject to and required to pay the MFT. Regulated investment companies (RICs) and real estate investment trusts (REITs) organized as corporations are also subject to and required to pay the MFT.

Limited partnerships (LPs), limited liability companies (LLCs) not classified as corporations, limited liability partnerships (LLPs), and qualified Subchapter S subsidiaries (QSubs) are required to pay an annual tax equal to the MFT, but are not subject to a “measured” income tax.

Every corporation that incorporates or qualifies to do business in this state is exempt from the MFT for the first taxable year of existence. This exemption is inapplicable to any corporation that reorganizes solely for the purpose of avoiding payment of the MFT. In addition, the first-year exemption is inapplicable to the annual taxes paid by LPs, LLCs not classified as corporations, LLPs, charitable organizations, RICs, REITs, REMICs, financial asset securitization investment trusts, or QSubs.

### **This Provision**

This provision, under the CTL, would eliminate the MFT of \$800 for all corporations by repealing the minimum tax provisions as of the date this bill is enacted. For example, if enacted during the 2018 legislative session, the MFT would be eliminated as of January 1, 2018.

### **Implementation Considerations**

The department has identified the following concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

Since other types of business entities reference the MFT to compute the annual tax, repealing the MFT provision would also have the effect of eliminating the annual tax for other entities. The author may wish to amend the bill to specifically repeal only the corporate MFT, leaving the provision intact to preserve the existing cross-references.

If this bill is enacted in late September or October of 2018, the department would have developed the forms and instructions for the 2018 taxable year. Thus, the department may incur additional costs to develop alternative forms and instructions in the short time frame necessary to ensure they are available for taxpayers to comply with the filing requirement. To alleviate these concerns, the author may wish to change the operative date for this provision to January 1, 2019.

The bill lacks a revision to the minimum tax provision in R&TC section 23151, which provides that a taxpayer pay minimum tax if it is greater than a taxpayer’s measured tax. If this is not the author’s intent, the bill should be amended.

The bill lacks a fixed operative date to coincide with a taxable year “beginning on or after,” therefore taxpayers with a taxable year that begins on a date other than the date the bill is enacted may be due a refund for minimum tax paid as required by the first estimated tax date. For clarity and ease of administration, this provision should be amended to be operative with respect to specified taxable years.

## Legislative History

AB 166 (Cook, 2011/2012) would have eliminated the MFT. AB 166 failed to pass out of the Assembly 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, Michigan, and Minnesota* do not impose a minimum tax on business entities.

*Illinois* imposes a \$25 minimum tax on corporations.

*Massachusetts* imposes a minimum tax of \$456 on corporations.

*New York* imposes a tax on corporations of \$25 to \$200,000 based on the corporation's in-state receipts. *New York* also imposes a minimum tax of \$25 to \$4,500 for LPs, LLCs, and LLPs based on their in-state receipts.

## Fiscal Impact

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

## Economic Impact

Fiscal Year (\$ in Millions)	2018-2019	2019-2020	2020-2021
Provision 4: Eliminate the minimum franchise tax	- \$1,600	- \$1,200	- \$1,300

Based on data from the FTB, it is estimated that in taxable year 2015 approximately 640,000 corporations and 550,000 LLCs, LPs, and LLPs were subject to the minimum tax under current law and would benefit from the elimination of the minimum tax.

The estimated revenue loss from the elimination of MFT for C and S corporations would be approximately \$490 million in the 2018 taxable year. This consists of \$580 million in minimum tax that would no longer be paid offset by measured tax of \$90 million. With the elimination of the MFT, corporations with positive income would be subject to measured tax. The estimated revenue loss from the elimination of minimum franchise for LLCs, LPs, and LLPs would be approximately \$570 million.

This results in an overall loss of approximately \$1.1 billion in the 2018 taxable year. The tax-year estimates are converted to fiscal years and then rounded to arrive at the amounts in the above table.

### **Support/Opposition**

Support: None provided.

Opposition: None provided.

### **Arguments**

Proponents: Some may argue that by eliminating the MFT, and by so doing, the annual tax, would increase business in California.

Opponents: Some may argue that the MFT is a small price to pay for the privilege afforded corporations that do business in California and therefore should not be eliminated.

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