



Analysis of Amended Bill

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Sponsor:

Bill Number: AB 2351

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Amended: March 19, 2018

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Related Bills: See Legislative
History

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 March 19, 2018, amendments removed the bill's provisions that would have made changes to the Education Code, relating to postsecondary education, and replaced them with the provisions discussed in this analysis.

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

Reason for the Bill

The reason for this bill is to provide funding for 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, 2020.

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 (PIT) rates on individuals ranging from 10 percent to 37 percent.

Existing state law imposes different PIT tax rates ranging from one percent to 12.3 percent.¹

Additionally, there is an additional 1 percent Mental Health Tax (MHT) on the portion of a taxpayer's taxable income that exceeds \$1,000,000.² 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. The (estimated) revenue from the additional 1 percent MHT is deposited into the Mental Health Services Fund on a monthly basis, subject to an annual adjustment.³

This Bill

For each taxable year beginning on or after January 1, 2020, this bill, under the PITL, 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 (\$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 provide a transfer schedule and funding mechanism substantially similar to the MHT provisions under Revenue & Taxation Code (R&TC) section 19602.5. No later than March 1, 2022, and each March 1 thereafter, the Department of Finance, in consultation with the Franchise Tax Board would determine the "annual adjustment amount" for the following fiscal year.

¹R&TC section 17041. 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 of 9.3 percent under 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 R&TC.

² R&TC section 17043.

³ R&TC section 19602.

The bill would leave unspecified the following:

- “Estimated tax liability increase from the additional tax” for tax years 2021 through 2024.
- “Estimated revenue from the additional tax” for fiscal years 2020-21 through 2023-24.

This bill, under the Education Code, would 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 Student Aid Commission for 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, and who are not subject to nonresident tuition and fees.

Implementation Considerations

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

Absent specified amounts for the “estimated tax liability increase from the additional tax” and “estimated revenue from the additional tax,” it is unclear how the transfer would be implemented.

Technical Considerations

This bill would create the Higher Education Assistance Fund under the Education Code section 69575; however, ACA 13 references section 102000 of the Education Code. For consistency, the references should be the same.

Legislative History

AB 1356 (Eggman, et al., 2017/2018), similar to this bill, under the Education Code, would have created the Higher Education Assistance Fund, and under the PITL, would have created an additional 1 percent tax on taxable income in excess of \$1 million. AB 1356 failed to pass by the constitutional deadline.

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 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 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 2351 as Amended on March 19, 2018
For Taxable Years Beginning On or After January 1, 2020
Assumed Enactment after June 30, 2018

(\$ in Billions)

Fiscal Year	Revenue*
2018-2019	\$0
2019-2020	+ \$1.3
2020-2021	+ \$2.1

*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 of the 2017-18 regular session 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 or for the net final payment method of accrual.

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 2018-19, the estimated revenue from the MHT would be approximately \$2.2 billion for fiscal year 2018-19. Using this amount as a baseline and taking into account the operative date of January 1, 2020, it is assumed the revenue from this bill for fiscal year 2019-20 would be approximately \$1.3 billion and \$2.1 billion for fiscal year 2020-21.

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.

The \$1 million income threshold would apply regardless of taxpayer filing status. An individual filing as single would be subject to the additional tax at the same income level as a married couple filing jointly. Thus, this bill would create a marriage penalty.

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

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