STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Lee, et al.

Sponsor:

Bill Number: AB 2289

Related Bills: See Legislative History

Introduced: February 16, 2022
Amended: April 28, 2022

SUBJECT

Wealth Tax Act

SUMMARY

This bill would add Part 27, the Wealth Tax Act (WTA), under Division 2 of the Revenue and Taxation Code (RTC), that would impose an annual wealth tax (WT) on a taxpayer's worldwide net worth (WNW) in excess of specified amounts, in addition to the income tax imposed under Part 10, Personal Income Tax Law (PITL) (commencing with Section 17001). This bill would also extend the False Claims Act (FCA) under the Government Code (GC) to include claims, records, or statements made under the WT that exceed $200,000.

This bill would only become operative if Assembly Constitutional Amendment (ACA) 8 of the 2021-2022 Regular Session is approved by the voters. ACA 8, amended on April 28, 2022, would authorize the Legislature to impose a tax on all forms of personal property or wealth, whether tangible or intangible, and would require any tax so imposed to be administered and collected by the Franchise Tax Board (FTB) and the Department of Justice (DOJ), as determined by the Legislature.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The April 28, 2022, amendments:

- Added the WT to the items the FTB could consider in written closing agreements under Article 6 of the RTC (commencing with Section 19441).
- Modified the definition of the Internal Revenue Code (IRC) to mean the definition as provided in the RTC.
- Modified that the WT would be imposed on "wealth-tax residents" rather than nonresidents.
- Added a WT resident definition.
- Clarified that a dependent of any taxpayer is not subject to the WT.

- With the exception of one item, modified the mandatory requirements for the FTB to adopt regulations to instead be discretionary.
- Made other nonsubstantive changes.

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

REASON FOR THE BILL

The reason for the bill is to raise additional annual revenue for reinvestment into California communities.

ANALYSIS

This bill analysis provides discussion of the following provisions:

1) General Application
2) Taxpayers Subject to the Wealth Tax
3) Administration of the Wealth Tax
4) Worldwide Net Worth
5) Wealth Tax Credit
6) Business Entity and Trust Reporting Requirements
7) Submission of Certified Appraisals
8) Wealth Tax Agreements
9) Penalties
10) Use of Consultants
11) Reporting Requirements
12) Adoption of Regulations
13) Wealth Tax Advisory Council
14) Wealth Tax Administration Fund

1) General Application

For taxable years beginning on or after January 1, 2023, and before January 1, 2025, this bill would initially impose an excise tax of 1.5% upon the WNW of every resident, part-year resident, temporary resident, or WT resident, as described, in this state in excess of the following:

- For married taxpayers filing separately (MFS), $500,000,000.
- For all other taxpayers, $1,000,000,000.

For taxable years beginning on or after January 1, 2025, this bill would impose an excise tax of 1% upon the WNW of every resident, part-year resident, temporary resident, or WT resident, as described, in this state in excess of the following:

- For MFS, $25,000,000.
- For all other taxpayers, $50,000,000.

In addition to the 1% excise tax, for taxable years beginning on or after January 1, 2025, this bill would also impose an additional .5% surtax (for a total combined tax rate of 1.5%) on the WNW of every resident in excess of the following:

- For MFS, $500,000,000.
- For all other taxpayers, $1,000,000,000.

The WNW of a taxpayer would be calculated in the same manner as the calculation of the Federal Estate Tax under Chapter 11 (commencing with Section 2001) of Subtitle B of the IRC, only to the extent allowable under the California Constitution, the United States (US) Constitution, and other governing federal law, and would be based on the value of all worldwide property owned by the taxpayer on December 31 of each year.

Any transaction with a primary purpose of reducing the valuation of a taxpayer's WNW as of December 31 would be disregarded.

This bill defines the following terms:

- "Dependent" has the same meaning as that in IRC section 152, and generally means a child or relative that lives with the taxpayer for at least half the year, and the taxpayer provides at least half of the child or individual's total support for the tax year.
- "GAAP" means generally accepted accounting principles.
- "Internal Revenue Code" has the same meaning as that in RTC section 17024.5.
- "Person" means individuals, fiduciaries, partnerships, limited liability companies, and corporations.
- "Related persons" means any person that is related to the taxpayer under either IRC section 267 or 318, plus any other person so specified via regulations adopted by the FTB.

The provisions of the WTA would be liberally construed to effectuate its purposes. The provisions of the WTA are severable. If any provision of the WTA or its application is held invalid, that invalidity would not affect other provisions or applications that could be given effect without the invalid provision or application.

2) Taxpayers Subject to the Wealth Tax

Residents, part-year residents, temporary residents, or WT residents would be subject to the WT. A person would only be considered a resident, a part-year resident, a temporary resident, or a WT resident if the individual cannot be claimed as a dependent of another taxpayer.

A taxpayer would be considered a "resident" for purposes of the WT for a given year if the taxpayer is considered a resident as defined for personal income tax purposes under RTC section 17014, which generally includes every individual that is in the state for other than a temporary or transitory purpose.

A taxpayer would be considered a "part-year resident" as that term is defined for personal income tax purposes under RTC section 17015.5, which includes a taxpayer that is both a resident and nonresident of this state during the taxable year. Part-year residents would be taxed on their WNW, but for purposes of calculating the WT, the taxpayer's WT liability would be multiplied by the percentage of days in the year the taxpayer was present in the state. Any partial year of residence would be subject to rules as described below.

A taxpayer would be considered a "temporary resident" if the taxpayer does not qualify as a resident or part-year resident, and the taxpayer has substantial presence in this state. A person has substantial presence in this state if they satisfy the rules of IRC section 7701(b)(3), except "the United States" would be replaced by "this state."

In general, an individual would meet the substantial presence test for the calendar year if the:

- Individual is present in California for at least 31 days during the calendar year, and
- The sum of the number of days present in California during the current year and the two preceding calendar years (multiplied by the applicable multiplier) equals or exceeds 183 days. (The applicable multiplier for the first preceding year is one-third and the multiplier for the second preceding year is one-sixth.)

Temporary residents would be taxed on their WNW, but for purposes of calculating the WT, the taxpayer's WT liability would be multiplied by the percentage of days in the year the taxpayer was present in the state.

A taxpayer would be considered a "wealth-tax resident" if the person has wealth sourced to this state as described below.

For part-year, temporary, or WT residents, the following rules would apply.

In general, the portion of a taxpayer's wealth subject to the WT would be multiplied by a fraction, the numerator of which would be the number of years of residence in California over the last four years, and the denominator would be four. For purposes of calculating the numerator, any partial year of residence calculated as follows would be included in the numerator:

- For new residents who have never been a resident in a prior year, the calculation of the numerator would be zero. For each subsequent year, the number one would be added until the numerator reaches four.
- For a WT resident, who was subject to the WT in one of the preceding four years and is no longer a resident, and does not have the reasonable expectation to return to the state, then the denominator of the fraction would be four, and the numerator of the fraction would be as follows:
    - For the first year the taxpayer is not a resident, the numerator would be a fraction between zero and 1, based on the percentage of days in the year the taxpayer was present in the state, plus the years of residence over the three previous taxable years.
    - For each subsequent year, the numerator would be reduced by 1 until the numerator reaches zero.

The bill provides that if these apportionment provisions do not fairly represent the extent of the benefit granted to the taxpayer to accumulate extreme wealth in this state, the taxpayer would be able to petition for, or the FTB would be able to require, use of an alternative apportionment method. The burden to demonstrate by clear and convincing evidence that the standard method is unfair and that a more fair and reasonable method is available would fall on the petitioning party. The FTB would be able to adopt appropriate rules or regulations for determining alternative apportionment methods for these situations.

The Legislature expects that most full-time postsecondary students would not have any wealth deemed as accumulated in California while a student.

Section 50313 provides the rules for taxpayers subject to the WT. In the event any provision of this section would be found by a court to be invalid, unconstitutional, or otherwise unenforceable, that finding would not affect the enforceability of any other provision of this section.

<u>3) Administration of the Wealth Tax</u>

Every taxpayer would be required to annually file a WT return at the same time they file their income tax return under the PITL to report their WNW and pay the WT, or to declare that their total WNW falls below the exemption amounts.

Unless specifically stated, the rules provided under Part 10.2, the Administration of Franchise and Income Tax Law (AFITL) (commencing with Section 18401), relating to the collection and administration of franchise and income tax, would apply to the WT. In addition, the WT and related interest and penalties would be added to the items the FTB can consider in written closing agreements authorized under Article 6 of the AFITL (commencing with Section 19441).

Regardless of any other law, every notice of a proposed WT deficiency assessment relating to taxable years beginning on or after January 1, 2023, and before January 1, 2025, would be required to be mailed to the taxpayer within ten years after the return is filed.

Within six months after enactment of this bill, the FTB would be required to make available the forms required for taxpayers to pay the WT. Those forms may provide for taxpayer attachments demonstrating compliance. However, the FTB would not be required to adopt any WT information reporting forms until January 1, 2025.

Notwithstanding any other provision of law, the FTB would be authorized to hire and pay reasonable fees to any outside expert or outside counsel, as appropriate, to help fully administer and collect the WT.

Furthermore, the bill's findings and declarations provide that sensitive California taxpayer information should be adequately protected from disclosure during the process of the assessment and collection of taxes to protect privacy and increase compliance.

4) Worldwide Net Worth

The WNW of a taxpayer would be calculated in the same manner as the calculation of the Federal Estate Tax under Chapter 11 (commencing with Section 2001) of Subtitle B of the IRC and only to the extent allowable under the California Constitution, US Constitution, and other governing federal law, based on the value of all worldwide property owned by the taxpayer on December 31 of each year.

For purposes of reporting WNW, the taxpayer would be required to separately report assets within the following 18 categories. This includes, but is not be limited to, the following:

1) Stock in any publicly and privately traded C-corporation
2) Stock in any S-corporation
3) Interests in any partnership
4) Interests in any private equity or hedge fund
5) Interests in any other non-corporate businesses
6) Bonds and interest-bearing savings accounts

7) Cash and deposits
8) Farm assets
9) Interest in mutual funds or index funds
10) Put and call options
11) Futures contracts
12) Art and collectibles
13) Financial assets held offshore
14) Pension funds
15) Other assets, excluding real property
16) Debts other than mortgages or other liabilities secured by real property
17) Real property
18) Mortgages and other liabilities secured by real property

Real property that is directly held by the taxpayer, and the mortgages and other liabilities secured by the directly held real property, would be reported separately. However, the value of these items would not be considered in the calculation of the taxpayer's WNW. In addition, WNW would not include any tangible personal property directly held by the taxpayer that is located outside of this state. Regardless of being excluded from the tax computation, the value of these assets would be reported on the taxpayer's annual return. At a minimum, a percentage of each taxpayer's overall liabilities, equal to the percentage of the taxpayer's directly held real property interest bears to all of the taxpayer's worldwide assets, would be excluded from the calculation of the taxpayer's WNW.

WNW would include the value of real property or out-of-state tangible personal property held indirectly, as through a corporation, partnership, limited liability company (LLC), trust, or other such legal form, except to the extent that such inclusion is prohibited by the US Constitution or other governing federal law.

The assets of a person that can be claimed as a dependent by the taxpayer that exceed $50,000 would be deemed to be assets of the taxpayer.

In addition, certain assets transferred by the taxpayer to a related party or to any party where the transferor retains control of or directly benefits from the transferee's use of the transferred asset would be included in the taxpayer's WNW.

With respect to these transfers:

- If an asset is transferred to a an IRC section 501 charitable trust, and the grant is subject to conditions imposed by the donor, this would generally not constitute "control" if the conditions imposed do not allow use of the asset to provide a private benefit to the donor and would be excluded from the taxpayer's WNW.

- If a taxpayer receives consideration other than services, the amount included in the transferor taxpayer's worldwide wealth would be reduced by the amount of consideration received, limited to the fair market value (FMV) of the transferred asset. However, any consideration subsequently received would be included in the taxpayer's worldwide wealth. If any consideration includes an assumption of a taxpayer's liability, the amount of consideration credited could not exceed the amount by which that liability would have reduced the worldwide wealth of the taxpayer.
- If an asset is transferred to any trust that has a potential beneficiary, who is a related person to the taxpayer, the taxpayer would be considered to have retained control, and the asset would be included from the taxpayer's worldwide wealth.
- As a result of these provisions, if any asset or portion of an asset would be taxed to more than one taxpayer in a given tax year, that asset would only be included in the worldwide wealth of the taxpayer for which inclusion would result in the greatest amount of tax. If two or more taxpayers would owe an equal amount of tax as a result of that inclusion, the asset would be included in the WNW of the owner.

5) Wealth Tax Credit

The value of all assets subject to the WT would be required to be reported annually by the taxpayer. However, any amount of net-worth WT paid on those assets to another jurisdiction would be credited against the WT, but could not reduce the WT below zero. The WT credit would only provide a credit for a tax paid on net worth. No credit would be created by any other tax, including, but not limited to, a tax whose amount is determined by reference to the occurrence or amount of any transaction, income, capital gains, death, or inheritance, whatever the economic incidence of that tax.

For a taxpayer who owns real property indirectly, through a corporation, partnership, LLC, trust, or other legal form, there would be allowed as a WT credit against the WT in an amount equal to the taxpayer's pro rata share of any property taxes paid on the gross or net value of real property to any jurisdiction. This credit would be limited to taxes paid with regard to ownership of the real property, and no credit would be created by any transactions tax, excise tax, or any other tax based on use of the property. The credit for each separate unit of real property would not exceed the portion of the taxpayer's total WT liability attributable to the taxpayer's ownership interest in that real property.

To claim the credits related to real property held indirectly, the taxpayer would be required to separately report each of the following items:

- FMV of each unit of real property.
- Assessed value used to calculate any creditable property taxes imposed on each unit of real property.
- Property taxes paid, for which credit is being claimed.
- All mortgages and other liabilities secured by or used for the purpose of each unit of real property.

6) Business Entity and Trust Reporting Requirements

All non-publicly traded business entities, other than sole proprietorships, doing business in or organized in California, or registered with the California Secretary of State would be required, under penalty of perjury, to file an annual information return with the FTB, providing information needed to calculate the value of the business, and the individual owners, including their residency status, address, taxpayer identification number, and their distributive share of the entity's net income if distributed. The same filing requirements apply to trusts required to file in California, relating to the value of the trust assets. Copies must also be provided to the business entity and trust owners that hold an interest in the entity at any time during the taxable year.

The FTB would be required to request this information from a business entity or trust if the FTB reasonably believes the business entity or trust contributes substantial wealth to a taxpayer subject to the WT.

7) Submission of Certified Appraisals

The bill provides appraisal rules relating to the wealth tax. When a taxpayer submits a certified asset appraisal, the taxpayer would be required to file an agreement in the form and manner as required by the FTB, as specified. The certified appraisal must provide a signed declaration as to whether the appraiser has "high," "medium," or "low" confidence. Any appraiser making a certified appraisal would be required to send a copy of that certified appraisal to the FTB, provide taxpayer identification for whom the certified appraisal was prepared, and follow any applicable instruction or regulation adopted by the FTB.

The FTB would be required to mail a notice of a proposed WT deficiency assessment to a taxpayer within five years of filing an agreement.

8) Wealth Tax Agreements

The bill provides detailed rules for agreements in the case of valuing assets where there are varying degrees of confidence indicated in the appraisal. These agreements are referred to as Liquidity-based Optional Unliquidated Tax Claim Agreements

(LOUTCA) and Optional Unliquidated Tax Claim Agreements (OUTCAs) and would be entered into with the FTB. Both the LOUTCA and the OUTCA would be initiated by following the form and manner as prescribed by the FTB, and would have the effect of creating a binding contractual agreement between the taxpayer and the state.

9) Penalties

WT Understatement Penalty

The taxpayer would be subject to an understatement of tax penalty for any taxable year where the understatement exceeds the greater of either:

- $1,000,000.
- 20% of the WT shown on an original return, or shown on an amended return filed on or before the original or extended due date of the return for the taxable year.

The penalty would be 20% of any WT understatement, which would be the amount by which the tax imposed exceeds the amount of tax shown on an original return or shown on an amended return filed on or before the original or extended due date of the return for the taxable year. The penalty would be 40% of any WT understatement if that understatement was substantially the result of not reporting an asset or pursuant to regulations adopted by the FTB.

This penalty would be in addition to any other penalty imposed under the AFITL or any other law. A refund or credit for any penalty amount paid would only be allowed if the penalty was not properly computed by the FTB.

No penalty would be imposed on any WT understatement to the extent it is attributable to a change in law that becomes final after the earlier of either of:

- The date the taxpayer files the return for the taxable year for which the change is operative.
- The extended due date for the return of the taxpayer for the taxable year for which the change is operative.

A "change of law" would mean a statutory change or an interpretation of law or rule of law by regulation, legal ruling of counsel, within the meaning GC section 11340.9(b), or a published federal or California court decision. In addition, no penalty would be imposed to the extent that a taxpayer's understatement is attributable to the taxpayer's reasonable reliance on written advice of the FTB, but only if the written advice was a chief counsel legal ruling, within the meaning of RTC section 21012(a)(1) of the Taxpayers' Bill of Rights.

Appraiser Penalty

There is an appraiser penalty that would apply if an appraiser certifies with "high confidence" the value of reported assets or property and it is subsequently determined that the actual value exceeds 150% of the reported amount. In this case, a penalty would be imposed on the appraiser that is equal to $10,000, plus 125% of the sum of all the payments the appraiser received from the taxpayer for the applicable appraisal services.

10) Use of Consultants

The FTB would be authorized to hire and pay reasonable fees to any outside expert or outside counsel, as appropriate, to help fully administer and collect the WT. This would include the use of independent appraisers. The FTB would be required to primarily prioritize the selection of independent appraisers, who have a demonstrated history of conducting accurate authorized independent appraisals, and secondarily prioritize the selection of independent appraisers, who have the best capacity and expressed commitment for conducting accurate authorized independent appraisals.

11) Reporting Requirements

Upon request by the Wealth Tax Advisory Council (WTAC) or the University of California (UC), the FTB would be able to disclose returns or return information for use in research relating to WT compliance or administration. The bill explicitly provides that data shared could be matched or otherwise combined with other sources. With respect to UC requests, the FTB would be required to establish procedures to identify allowable WT information that can be provided to the UC, to provide FTB's timeframe for responding in a reasonably timely manner, and to ensure that the request complies with the California Information Practices Act of 1977.

The UC would be required to utilize the information in a form and manner to safeguard the tax information as required by the FTB, including a data exchange security questionnaire provided by the FTB prior to approval of a data exchange; and to allow onsite safeguard reviews to be conducted by the FTB. In addition, UC employees would be required to complete disclosure training as provided by the FTB and sign confidentiality statements acknowledging awareness of penalties for unauthorized access or disclosure.

The requester would be required to notify the FTB within 24 hours of any unauthorized access or disclosure. In addition, the requester would be required to make the information unusable in a timeframe as specified by the FTB.

The FTB would be able to require reimbursement for all direct costs incurred to provide the information. The FTB would also be authorized to use funds allocated by the WTAC for the costs relating to the establishment of these procedures.

By January 1, 2023, the FTB would be required to publish and post on the FTB website a rate of return report, as specified, for each of the prior 10 tax years, unless the FTB determines that some other methodology is more appropriate for a particular year or set of years. The report would be determined by adding 300 basis points to the rate of return on the most appropriate one-year US Treasury Bill for that year. The FTB would be required to publish the report for the prior year based on the best available methodology.

12) Adoption of Regulations

The bill provides that the FTB may adopt regulations for several aspects of the WTA to provide procedures and guidance relating to the implementation, administration, and collection of the WT. This would include:

- Abusive transactions, whose aim is to change the nature of an asset from public to nonpublic or vice versa, or whose aim is to artificially reduce the assessed value of a taxpayer's assets.
- Any other issue relating to valuation methods.
  - Annual reporting requirements of non-publicly traded business entities and trusts.
  - Substantiating who is a specified liquidity-constrained taxpayer and what is a designated highly illiquid asset related to LOUTCAs.
  - The requirements for certified appraisals and for appraisers to conduct the appraisals.
  - The apportioning taxpayer's overall liabilities to exclude liabilities related to directly held real property, which would provide that, at a minimum, a percentage of each taxpayer's overall liabilities, equal to the percentage the taxpayer's directly held real property interest bears to all of the taxpayer's worldwide assets, should be excluded from the calculation of the taxpayer's worldwide net worth.
  - Any and all regulations that are helpful and appropriate for implementing any WTA provision.

In addition, the FTB would be required to adopt regulations relating to the requirements for authorized independent appraisals of assets and the selection process for appraisers to conduct the appraisals.

Until January 1, 2025, the rule making procedures under the Administrative Procedure Act would not apply to any regulation, standard, criterion, procedure, determination, rule, notice, guideline, or any other guidance established or issued by the FTB relating to the WTA.

13) Wealth Tax Advisory Council

This bill would establish the WTAC, which would determine the adequate levels of annual funding to staff the administration and collection of WT for the FTB, the Office of Tax Appeals (OTA), and the DOJ, and would also make suggestions to the Legislature as to modifying the WT to improve its fairness and efficiency.

Within 40 days of the effective date of this bill, the Governor, the Treasurer, the Controller, the Legislature, and the FTB Executive Officer would be required to appoint one member from each of the following three categories: (1) a current or retired California revenue official; (2) a taxpayer representative; and (3) a policy analyst or academic. The WTAC would be able to proceed to operate if at least 60% of the appointments have been made.

Within 45 days of the bill effective date, the FTB Executive Officer would be required to convene a meeting with the appointed members to elect a chairperson and vice chairperson. WTAC actions may only be taken by a majority vote of a WTAC quorum. The bill also provides the term limits, that each member could be removed before the expiration of their term, and how that member would be replaced.

14) Wealth Tax Administration Fund

This bill would also establish the FTB Wealth Tax Administration Fund (WTAF) for the purpose of administering and collecting the WT or that part of administering other taxes that substantially advances the administration and collection of a WT. All money deposited in the WTAF would be continuously appropriated to the FTB, without regard to fiscal year, and would be required to be used solely for the purpose of administering and collecting a WT.

For each of the first four years a WT is collected, the amount that would be required to be deposited into the WTAF is the greater of:

- $300,000,000, adjusted the second year for inflation using the California Consumer Price Index; or
- 1% of all projected WT revenues for the taxable year.

For each subsequent year, the amount that would be required to be deposited into the WTAF is the greater of:

- $100,000,000, adjusted annually for inflation using the California Consumer Price Index.
- .5% of all projected WT revenues for the taxable year.

If the amount deposited into the WTAF over the prior three years exceeds the reasonable costs incurred to administer and collect the WT by the FTB over those years, the excess would be required to be transferred to the General Fund. If the reasonable costs incurred over those years are in excess of the amount deposited into

the WTAF, the WTAC would be required to provide a report to the Governor, and the excess would be required to be included in the Governor's budget proposal for the following fiscal year.

Effective/Operative Date

This bill would be effective January 1, 2023, and would only become operative if ACA 8 is approved by the voters. The WT provisions would be specifically operative for taxable years beginning on or after January 1, 2023, with some provisions, including the additional .5% surtax, specifically operative for taxable years beginning on or after January 1, 2025.

Federal/State Law

Federal Law

There is no federal provision comparable to the WT that would be created by the provisions of this bill.

Federal estate tax laws, under Chapter 11 (commencing with Section 2001) of Subtitle B of the IRC, impose a tax on the transfer of a taxable estate, which is determined by deducting from the value of the decedent's gross estate any deductions provided for in the IRC and other applicable provisions.

State Law

Existing state income tax law imposes nine different personal income tax rates, ranging from 1% to 12.3%, but does not currently have a WT. Additionally, there is a 1% Mental Health Tax on the portion of a taxpayer's taxable income that exceeds $1,000,000.

California does not conform to the federal estate taxes.

Implementation Considerations

FTB has identified several implementation considerations for this bill, some of which are discussed below. FTB would require significant lead time to "stand up" the WTA. Such a program would possibly require the equivalent of a new division within the Department to receive and process WT returns, payments and related business and trust information returns and to verify compliance. (Refer to Fiscal Impact below.) All aspects of implementation, administration including systems changes, collection, taxpayer education; the hiring and training of new staff; and the procurement of outside experts or counsel could not begin until after the enactment of this bill along with the voter approval of ACA 8. The author may wish to consider adding language that would provide at least approximately 3-4 years from the ACA 8 voter approval date to the WTA operative date.

Some implementation considerations include, but are not limited to:

- The bill provides that temporary residents and WT residents would file their WT returns when they file their income tax returns. However, temporary and WT residents, as defined in this bill, are new filing statuses for which there is no income tax filing requirement.
- There would be legal jurisdictional limitations for California to tax California "temporary" or nonresidents on non-California property.
- There would be practical limitations relating to the collection of debts. FTB would make every effort to collect debts under all legal statutes and jurisdiction; however, if the taxpayer resides outside of California, or the US, FTB may encounter difficulty collecting monies due if the taxpayer self-assessed but declined to pay.
- The data sharing requirement amongst the WTAC, the UC and the FTB is very broad. If the author's intent is to only apply to the UC Board of Regents versus all ten UCs, the bill language should be amended. In addition, the scope of filers for the reporting requirement would include all California residents, part-year residents, temporary residents, and WT residents. This would impact millions of individuals. If this is not the author's intent, the author should amend the bill language.
- The WTA would require FTB to verify the taxpayer's residency status, and the new categories of temporary residents and WT residents with significant wealth in the state, which can be a highly factual and time-intensive determination, especially when individuals may be traveling frequently or have assets among different states and countries. Additionally, "significant wealth" needs to be defined before FTB could implement this provision.
- The WTA provides an entirely new tax model. FTB does not currently have staff sufficiently sized or knowledgeable in the valuation of asset group categories and the federal estate tax rules. For federal purposes, the estate tax rules generally apply once, at a point in time, while for the purposes of AB 2289, taxpayers would be required to apply these rules annually. It is also unclear how the federal estate tax calculations would apply since different terminology is used in the federal estate tax rules and this bill.
- FTB would have limited access to information to verify reporting. Most state taxes are imposed on gross income or receipts, net income or a transaction. In addition, there are no federal provisions comparable to the WT that would be created by this bill. As such, there would be a limited ability to obtain information from other states, the Internal Revenue Service, or foreign jurisdictions, to leverage for purposes of verifying the accuracy of the reported WT and asset values reported by taxpayers. Taxpayers would have full responsibility to report their assets.

- Section 50302 provides that WT collection and administration would be governed by Part 10.2, the AFITL, however the WT is not assessed under Part 10.2. Several of the provisions under Part 10.2 specifically apply only to taxes imposed under Part 10, PITL, and Part 11, Corporation Tax Law (CTL). The author may want to consider whether these provisions should apply to the WT imposed under Part 27. For example, Section 19054 provides a rule for collection of overstated credits claimed under Parts 10 and 11 that would not apply to the WT imposed under Part 27. The administrative rules under Part 10.2 for return filing, amended return filing, return due dates, assessments, penalties, collection processes, disclosure safeguards, and settlement authority do not currently include references the WT imposed under Part 27. Consider amending the bill to clarify whether specific references to the WT should be added to Part 10.2.
- The LOUTCA and OUTCA provisions would add significant complexity to WT administration; some clarity would be needed for these provisions.
- The bill provides an appraiser penalty that would apply in certain situations. However, the bill does not provide any rules relating to the administration of the penalty, e.g., when it should be assessed, billing, collection, can the appraiser dispute the penalty, etc.
- Section 50306 provides that WNW would not include any tangible personal property directly held by the taxpayer and located outside of this state. However, WNW would include the value of real property or out-of-state tangible personal property held indirectly, as through a corporation, partnership, LLC, trust, or other such legal form. Consider clarifying for disregarded entities, e.g., single-member LLC, whether the entity that is disregarded for tax purposes, but holds the property, would be subject to the WT because it is not "owned directly" by an individual.
- Section 50311 provides the WT credit. Consider clarifying if the amount of the net-worth wealth tax paid to another jurisdiction relating to assets subject to the WT must be paid in the current taxable year.
- Section 50313(b)(4)(B)(ii) provides that the Legislature expects that most full-time postsecondary students will not have any wealth deemed as accumulated in California, however the language does not provide an exception to the WT for full-time postsecondary students or define a "full-time post-secondary student."
- The bill has several undefined terms, e.g., "accumulate extreme wealth," "designated highly illiquid assets," "economic incidence of that tax," "extreme wealth," "net worth tax base," "annual wealth tax base," "substantial wealth," "taxpayer," "partial year of residence," "de minimis employment," "California revenue official," "taxing authorities," "Estimated Economy-wide Normal Rate of Return," "throwback tax," "liquidity-constrained taxpayers," "alternative apportionment," "individual," etc. The absence of definitions to clarify these terms could lead to confusion and difficulty for taxpayers to comply with the WT provisions.

Technical Considerations

There are items needing clarity within the bill to ensure the program can be administered as intended and the bill produces the desired outcome. This includes recommendations for purposes of technical clarity, consistency in terminology, grammatical consistency, and other needed changes.

Technical considerations include, but are not limited to:

- In Section 50301.5(b), consider inserting, "(a) 'Taxpayer' shall have the same meaning as that term is defined in Section 17004.", and re-letter the section accordingly. In addition, the definition of "taxpayer" under RTC section 17004 and "person" under RTC section 17007 both include partnerships, and the latter, corporations. If making this amendment, the author may wish to verify the inclusion of partnerships and corporations is intended and how they might be impacted.
- In Section 50301.5(b), also consider inserting, "(b) 'Resident, Part-Year Resident, Temporary Resident, and Wealth-tax resident' shall have the same meaning as the term is defined in Section 50313.", and re-letter the section accordingly. In addition, perhaps clarify, if intended, that the WT would predominately apply to natural persons.
- Section 50303(d) provides that real property and mortgages and other liabilities secured by the real property are to be reported on the taxpayer's annual filing. However, these values would not be considered in the computation of the WT. Section 50306 provides the same and additional asset exclusions, and is silent as to the annual reporting requirement for these assets. Section 50312 also provides asset exclusions and specifics as to reporting those assets. The author may wish to combine these sections to clarify, remove duplication, and to state whether these assets would be required to be reported on the taxpayer's annual filing even though they are not considered in the WT computation.
- For clarity, replace Section 50305(c), "In addition to the tax imposed under subdivision (b), there is also hereby imposed an additional 0.5 percent surtax,…" with "*For taxable years beginning on or after January 1, 2025,* ~~I~~in addition to the tax imposed under subdivision (b), there is also hereby imposed an additional 0.5 percent surtax,…"
- Section 50309(b)(3) provides that within five years of completing a taxpayer FTB agreement, the FTB would mail the taxpayer a notice of proposed assessment. However, the statute is not clear as to the basis for the notice since 50309 relates to information returns.
- The FTB has the discretion to adopt regulations relating to all provisions of the bill except for Section 50308(c)(9)(E) that would require the FTB to adopt regulations relating to the requirements for authorized independent appraisals and for selecting appraisers for conducting those appraisals; consider verifying this was

intended. The general authorization to adopt regulations with respect to the entire act is sufficient and eliminates the need for authorizations throughout the bill.

Policy Considerations

Department staff has identified multiple policy considerations, some of which are listed below.

Policy considerations include, but are not limited to:

- The bill would require all California income tax filers, approximately 19-20 million filers, to annually file the WT form or return. It is estimated that there would be approximately 15,000 WT filers. In addition, the bill would require non-publicly traded business entities, other than sole proprietorships, doing business in or organized in California, or registered with the California Secretary of State, and trusts required to file in California, under penalty of perjury, to file annual information returns with the FTB, providing information needed to calculate the value of the business, and the individual owners and their distributive share of the entity's net income if distributed. This would place an undue burden on individuals, businesses, and trusts to comply. If this is not the author's intent, the author may wish to amend the bill language.
- For purposes of the WTAC, the author may wish to clarify WTAC's role in the administration of the WT, particularly in determining resource needs versus the existing process where the FTB determines resource needs and works with the Department of Finance (DOF) and the Legislature for budgeting purposes. Additionally, this bill would require any deficit funding needs to be funded by the General Fund in later years. Significant ramifications could occur to other General Fund budgeting priorities without existing oversight from the DOF and the Legislature.
- It is unclear whether and how a claim under the FCA and deployment of the department's enforcement tools would be coordinated. For example, if a taxpayer is currently under FTB examination or investigation, clarify how this would be affected by the FCA bill provisions.
- Consider clarifying if the standard state contracting practices under the Public Contract Code (PCC) and the Department of General Services (DGS) guidelines would apply. It is unclear if the intent is to exempt these procurement agreements from PCC and DGS oversight. In addition, Section 50308(c)(9)(D) would require the FTB to seek to promote accuracy in appraisals by prioritizing independent appraisers who demonstrate a history of conducting accurate appraisals. It is also unclear if these requirements conflict with PCC and DGS guidelines. It may be challenging, or in some cases not possible, to find appraisers qualified to appraise unique assets within a timely manner.

LEGISLATIVE HISTORY

ACA 8 (Lee, et al., 2021/2022), among other items, this measure would have authorized the Legislature to impose a tax upon all forms of personal property or wealth, whether tangible or intangible, and would have required any tax imposed to be administered and collected by the FTB and the AG. ACA 8 was held by the Assembly Revenue and Taxation Committee without further action.

AB 310 (Lee, et al., 2021/2022), similar to this bill, would have added Part 27, the WTA, under Division 2 of the RTC, to would impose an annual WT, in addition to the income tax imposed under Part 10, PITL (commencing with Section 17001), on a taxpayer's WNW in excess of specified amounts. AB 310 would have only become operative if ACA 8 of the 2021-2022 Regular Session was approved by the voters. AB 310 did not pass out of the Assembly by the constitutional deadline.

AB 1270 (Stone, 2019/2020) would have, under the GC, expanded the FCA to apply to claims, records, or statements made under the RTC, if specified conditions are met on or after January 1, 2020. AB 1270 did not pass out of the Assembly by the constitutional deadline.

AB 2088 (Bonta, et al., 2019/2020) would have created a WT, under the PITL, that would have imposed a .4% annual tax on a California resident's WNW in excess of $30 million, or in excess of $15 million in the case of a MFS. The bill would have described WNW with reference to specific federal provisions, and that WNW would not have included specific assets, including directly held real property or liabilities related to directly held real property. AB 2088 did not pass out of the Assembly by the constitutional deadline.

AB 2570 (Stone, 2019/2020) would have, under the GC, expanded the FCA to apply to claims, records, or statements made under the RTC, if specified conditions were met on or after January 1, 2021. AB 2570 did not pass out of the Senate Judiciary Committee.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The "stand up" of the WTA would necessitate the implementation of an entirely new program for the department, including systems to receive the WT returns and payments, as well as business and trust information returns; return processing; forms and instructions; outreach and education to all individual, trust, and business return filers; alternative valuation requests; customer service support; audits; resolution of protests, appeals, and requests relating to WT proposed adjustments; and the needed

staffing for all of these various associated functions. At a minimum, it is estimated the annual cost to operate such a program within the FTB would likely be at least $200-$300 million utilizing costs of current operations as a starting point. Start-up costs, such as technology upgrades, would be in excess of this amount.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gain:

Estimated Revenue Impact of AB 2289 as Amended April 28, 2022
Assumed Enactment after June 30, 2022

($ in Millions)

Fiscal Year	Revenue
2022-2023	+$5,800
2023-2024	+$9,300
2024-2025	+$15,000

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

Using data from Forbes annual billionaire's publication, it is estimated that California billionaire's WNW would be approximately $1 trillion in 2023. Of that amount, it is estimated that wealth in excess of $1 billion (or $500 million for MFS) would be approximately $800 billion. In addition, this estimate includes a reduction for valuation issues and taxpayer behavior responses that reduce the amount subject to the excise tax to about $600 billion. Applying the 1.5% excise tax results in a revenue gain of $9 billion in the 2023 taxable year. This amount increases to $18 billion in taxable year 2025 when amounts subject to the excise tax are reduced to $50 million (or $25 million for MFS) with an applicable excise tax rate of 1% and an additional .5% surtax for amounts in excess of $1 billion (or $500 million for MFS).

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

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

None on file.

ARGUMENTS

None on file.

LEGISLATIVE CONTACT

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