CALIFORNIA BUDGET PROJECT

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# WHAT'S IN THE CONFERENCE COMMITTEE'S REVENUE PACKAGE?

A series of measures aimed at boosting 2008-09 revenues would provide the revenues needed to support the Conference Committee's spending plan. The revenue measures would be enacted as one or more "trailer" bills that would accompany the budget. The Conference Committee's plan:

1. **Reinstates 10 percent and 11 percent tax brackets on high-income Californians.** The Conference plan would impose a 10 percent rate on the earnings of joint taxpayers with incomes above $321,000 ($160,500 single) and an 11 percent rate on joint taxpayers with incomes above $642,000 ($321,000 single) to raise $5.6 billion. The new brackets would apply at incomes similar to those subject to 10 percent and 11 percent rates during the early 1990s. Approximately 575,000 taxpayers would be subject to the new rates. A portion of the additional amount would be offset by larger federal tax deductions for taxpayers who itemize their deductions for federal tax purposes.

2. **Maintains the 2007 income tax tables in 2008.** This provision would essentially suspend indexing –the adjustment of the income tax tables for inflation – of the personal income tax rates schedule for the 2008 tax year. As a result, each of the state's tax rates would apply at slightly lower income levels than would otherwise occur. This provision would raise $815 million. The Senate Budget and Fiscal Review Committee reports that a taxpayer with a taxable income of $50,000 would pay an additional $34, while one with a taxable income exceeding $97,000 would pay approximately $180 more in taxes. A portion of the additional amount would be offset by larger federal tax deductions for taxpayers who itemize their deductions for federal tax purposes.

3. **Reduce the dependent tax credit for high-income households.** In the late 1990s, the state expanded the dependent tax credit to approximately three times the amount of the personal credit. (In 2007, the dependent credit was $294 while the personal credit was $94). The conference agreement would roll back the dependent credit to the amount of the personal credit for taxpayers with incomes above $150,000 to raise $215 million. Similar to the provisions listed above, taxpayers who itemize their federal deductions would have a portion of the additional amount offset by a lower federal tax bill.

4. **Restore the corporate income tax rate to 9.3 percent.** The corporate income tax rate was reduced to 8.84 percent in 1997. Prior to that time, the corporate rate was equal to 9.3 percent – the top rate for personal income taxpayers. This provision would raise $470 million. The corporate rate would remain lower than the proposed new top personal income tax rates proposed by the Conference Committee plan. Corporations could deduct their added California taxes from the federal income taxes, which would offset approximately a third of the added costs.

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5. **Temporarily suspend businesses' ability to claim Net Operating Loss (NOL) deductions and then double the period that businesses can carry these losses forward.** The Conference proposal would suspend businesses' ability to deduct prior years' losses from their income for three years and then double the length of time that businesses can carry losses forward from 10 to 20 years. This provision is similar to an action taken in 2002, when the budget package expanded the amount of losses businesses could carry forward and extended the carry-forward period for an additional two years. This year's proposal would generate an estimated $1.1 billion in 2008-09. The state would experience a modest increase in revenues lost due to NOL deductions after the expiration of the sunset. Legislative summaries have not detailed the future years' loss due to this provision. Businesses would not lose the value of their deduction, but would be required to claim their deductions later than would occur under current law. Large corporations, including many in the manufacturing and financial sectors, primarily claim NOLs. Some observers believe that the revenue gain from this provision could be lower than anticipated, since businesses are likely to have lower incomes against which losses can be claimed due to the downturn in the economy.

6. **Establish a tax amnesty period.** The Conference agreement would establish a tax amnesty, aimed at accelerating the collection of tax revenues already owed under current law. While legislative documents have not provided details as to how the amnesty might be structured, Budget Committee summaries note that their proposal is similar to the amnesty included as part of the 2004-05 budget agreement. Amnesties typically allow taxpayers owing prior years' taxes to pay these amounts with minimal or no penalties and/or interest during a specified period and then impose tougher penalties on outstanding obligations at the end of the amnesty.

   Analyses of the state's 2005 amnesty found that approximately 80 percent of the additional revenues received were acclerated collections of amounts that the state would have received in the absence of the amnesty, while approximately 20 percent of the collections represented "new money." The Legislative Analyst's Office reported that:

   > "About one-fifth of the amnesty-related payments received was attributable to the program's voluntary participants, while the remaining four-fifths was attributable to companies that chose not to participate in the amnesty program but still chose to file so-called 'protective claim' payments. These are payments made by these taxpayers to avoid the possibility of being charged high post-amnesty penalties if their outstanding tax challenges are not ultimately upheld, or if they receive future audit assessments related to past tax years. … The majority of the payments received are expected to be offset by lower net collections in the future."[1]

   Sources report that the percentage of the collections that would be received under the Conference proposal representing accelerated, rather than new, revenues could be even larger than during the last amnesty. This reflects the fact that the last amnesty was only three years ago, and many taxpayers with longstanding obligations came forward and paid their taxes at that time. Many tax policy experts argue that amnesties, or too frequent amnesties, can undermine tax administration efforts by giving taxpayers the impression that they can avoid paying taxes and then come forward during an amnesty and avoid the penalties that would otherwise be imposed. The Conference proposal assumes that the state would receive an additional $1.5 billion in one-time revenues in 2008-09.

[1] Legislative Analyst's Office, *Analysis of the 2006-07 Budget Bill* (February 2006), p. 56.