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February 11, 2005

Hon. Bill Lockyer
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Tricia Knight
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative (File No. SA2005RF0008). This proposed statutory measure would repeal the Mental Health Services Act.

Background

Proposition 63 Enacted. In November 2004, California voters approved Proposition 63, also known as the Mental Health Services Act. The statute provides additional state funding for various mental health programs identified in its provisions by establishing a personal income tax (PIT) surcharge of 1 percent on amounts of taxable incomes in excess of $1 million. The PIT surcharge is levied on all tax filers effective January 1, 2005. Revenues generated by the new tax surcharge would be deposited into a new special fund.

The Department of Mental Health (DMH), in coordination with certain other state agencies, has the lead role in implementing most of the programs specified in the act through contracts with counties. Each county is directed by the act to draft and submit for state review and approval a three-year plan for the delivery of mental health services within its jurisdiction. The Franchise Tax Board (FTB) is the lead state agency responsible for administration of the tax provisions. The act permits up to 5 percent of the funding allocated annually from the Mental Health Services Fund to be used to offset state costs for implementation of the measure. Up to an additional 5 percent share of the allocations from the special fund is to be used annually for county planning and other administrative activities to implement the act.

The act specifies that the revenues generated from the tax surcharge must be used to expand mental health services and cannot be used for other purposes. In addition, the state and counties are prohibited from redirecting funds now used for mental health services to other purposes. The state is specifically barred from reducing General Fund support, entitlements to services, and formula distributions of funds now dedicated for mental health services below the levels provided in 2003-04. The state is also prohibited from changing mental health programs to increase the share of their cost borne by a county or to increase the financial risk to a county for the provision of such services unless the state provides adequate funding to fully compensate for the additional costs or financial risk.

Implementation of Act Has Started. State agencies and the counties have begun implementing the Mental Health Services Act. The DMH estimates that by April it will release an initial round of about $13 million in funding generated under the new law for grants to counties to prepare their three-year plans for the expansion of mental health services. Allocations of larger sums of Mental Health Services Act funding derived from the new income tax surcharge, which are to be used for the actual expansion of mental health services, are expected to begin occurring this fall. The state and counties are also discussing the implementation of the Mental Health Services Act with private providers of mental health services. A number of counties contract with such private providers for the delivery of mental health services in their communities.

Initiative Proposal

This initiative measure would repeal the Mental Health Services Act in its entirety, effective upon its approval by voters. The measure states that the repeal shall be applied retroactively. In addition, it specifies that all funds disbursed to DMH or any other state or local entity are to be returned to the state so that they can, in turn, be refunded to individual taxpayers.

Fiscal Effect

State Revenue Decreases. The repeal of the PIT surcharge would reduce state revenues by approximately $275 million in 2004-05, $750 million in 2005-06, $800 million in 2006-07, and increasing amounts annually thereafter. These are the amounts that are projected to be generated by the new tax surcharge.

Net Decreases in State and County Expenditures. If this measure were enacted, state and county spending would generally be reduced commensurately with the reduction of state revenues discussed above. In other words, state and local government spending levels for mental health programs would eventually be about $800 million a year less than would otherwise have been the case under the Mental Health Services Act. These reductions in spending would be ongoing, and would include the elimination of millions of dollars annually in spending for state and county administration of the Mental Health Services Act. The $800 million per year spending reduction would probably be partly offset by increased expenditures for some state and local programs, such as prison or jail operations, given that mental health services would not be expanded if the law is repealed.

Onetime Taxpayer Refunds. This measure would result in a onetime refund to taxpayers, potentially in the hundreds of millions of dollars, of the new tax revenues collected under the Mental Health Services Act. The amount of refunds would depend primarily upon when this measure was placed before the voters for their approval, and the amount of Mental Health Services Act funding that was collected and expended by the state and counties before its repeal by this initiative.

The amount of these refunds would also depend upon how and if existing state and federal constitutional provisions prohibiting the impairment of private contracts, as well as certain other potential legal issues, affected the obligation of the state and counties to return Mental Health Services Act funds. The potential effect, if any, of these legal constraints upon the amount of funding that would be subject to return to the state and, subsequently, the taxpayers is unknown.

Given the relatively small number of taxpayers eligible for refunds, the onetime state cost for the FTB to issue refund checks would probably not exceed $1 million.

Reduction in Federal Funds. If this measure is enacted, the state and the counties would not experience an increase in the receipt of federal funds that might result from the expansion of mental health services under the Mental Health Services Act.

Prohibition on Spending Reductions Ended. Depending upon the state's fiscal circumstances in the future, this initiative could result in a reduction in General Fund expenditures for community mental health programs below the level that would otherwise occur under the Mental Health Services Act. As noted earlier, the law contains provisions that prohibit the state from reducing General Fund support for mental health programs below the 2003-04 level and that restrict certain other changes in mental health programs. Repeal of these provisions means that the Legislature and Governor would again have the authority to reduce state spending or modify the structure of the programs in the future without regard to the current requirements of the Mental Health Services Act.

Summary

- State revenue decreases of approximately $275 million in 2004-05, $750 million in 2005-06, $800 million in 2006-07, and increasing amounts annually thereafter, with commensurate ongoing reductions in expenditures by the state and counties for mental health programs. These reductions in expenditures could be partly offset by increased costs for other state and local programs.
- Unknown onetime refund to taxpayers, potentially as much as hundreds of millions of dollars, of tax revenues collected and expended under the Mental Health Services Act prior to its repeal.

Sincerely,

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Elizabeth G. Hill
Legislative Analyst

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Tom Campbell
Director of Finance