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November 26, 2007

Hon. Edmund G. Brown Jr.
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Krystal Paris
Initiative Coordinator

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed the statutory initiative relating to state taxation (A.G. File No. 07-0072).

Background

The state levies a personal income tax (PIT) on the California income of individuals. The sum total of all of a taxpayer's income from all sources is known as total income. Taxpayers are allowed to deduct certain expenses (known as "above-the-line" deductions) from this amount. The result is what is called the taxpayer's adjusted gross income (AGI). Taxpayers then are allowed either to claim a standard deduction or deduct certain itemized expenses from their AGI when computing their taxable income and tax liability. One class of itemized deductions allowed is for the amount of qualified medical care expenses that are in excess of 7.5 percent of the taxpayer's AGI.

Provisions of the Initiative

This measure's apparent intent is to include—as a new above-the-line deduction when computing AGI—expenses paid or incurred for dietary supplements and foods for special dietary needs, as defined. It would also expand the definition of medical care expenses deductible for state PIT purposes to include purchases of dietary supplements and foods for special dietary needs.

Fiscal Effects of the Initiative

If approved by the voters, the addition of a new above-the-line deduction for dietary supplements and foods for special dietary needs would result in an annual PIT revenue reduction of a bit over $200 million annually once fully phased in. There is some ambiguity in the measure's wording, however, that could be interpreted as having the new above-the-line deduction *replace* (versus supplement) all other above-the-line deductions. If the measure were adopted and interpreted in this manner, it would increase annual PIT revenues by approximately $500 million dollars once fully phased in. This is because under such an interpretation, the increase in revenue from taxpayers' loss of currently available above-the-line deductions would be much greater than the revenue loss from the newly created deductions.

Summary of Fiscal Effects. The measure would have the following fiscal effect:

- Annual ongoing reduction in state revenues of approximately $200 million, assuming the measure's effect is only to add a new above-the-line deduction for dietary supplements and foods for special dietary needs.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Michael C. Genest
Director of Finance