December 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 proposed initiative related to state taxes and student fees (A.G. File No. 07-0084).

Background

State Income Tax. Under current law, the state taxes income above $1 million at a rate of 10.3 percent. This rate was raised from 9.3 percent in 2004 as a result of an initiative that added a 1 percent surcharge for this income bracket. The 1 percent surcharge funds county mental health programs.

Student Fees. The state maintains two public university systems: the University of California (UC) and the California State University (CSU). While the state provides funding to the universities for most of the cost of educating their students, the students pay a portion of these costs through education fees (often called "tuition" in other states).

Under existing law, UC's Board of Regents and CSU's Board of Trustees set the fees that are paid by their respective students. State law provides no formula or specific guideline for the governing boards to use in setting annual fees. Actual fee levels for undergraduate students have varied considerably in recent years. In some years, fees have increased by as much as 40 percent, while in other years they have remained unchanged and in several years they have actually declined. For 2007-08, UC and CSU's resident undergraduate fees are $6,636 and $2,772, respectively.

Proposal

Income Tax Increase. This proposal adds—beginning in 2009—a new 1 percent surcharge on personal income above $1 million. This would establish a top state income tax bracket of 11.3 percent. It directs 60 percent of the new income tax revenues to the two university systems for undergraduate education. This funding would be split between UC and CSU in proportion to their relative fee totals in 2006-07—about 55 percent for UC and 45 percent for CSU. However, if UC were not to adopt the measure's fee restrictions (see below), CSU would receive *all* of the new funding available for undergraduate programs. The measure does not formally restrict the remaining 40 percent to any specific state purpose. However, because of existing law, the collection of new tax revenue would increase the state's annual minimum spending requirement for K-14 education (K-12 schools and California Community Colleges).

Student Fee Freeze. This proposal freezes CSU resident undergraduate fees at their 2008-09 level for five years. After that period, the proposal would limit subsequent fee increases to no more than the annual percentage change in the California Consumer Price Index. The same fee freeze and subsequent annual fee increase limits would only apply to UC if the Regents adopted them by resolution. This is because the UC Board of Regents, unlike the CSU Trustees, derives its authority from the State Constitution, rather than statute. The Regents' authority to set fee levels cannot be reduced through an initiative statute such as this one.

Fiscal Effects

Impact of the Tax Provision. The 1 percent income tax surcharge would generate about $2 billion a year (with the first full-year effect starting in 2009-10). The two university systems together would receive 60 percent of this new revenue, or roughly $1.2 billion each year. The remaining 40 percent would be available for general state purposes. We estimate that this general purpose funding would be sufficient to cover the increased K-14 spending obligations, described above.

Impact of the Student Fee Revenue Provisions. The fiscal impact of the fee freeze would depend on what otherwise would happen to UC and CSU fee levels. For example, if fees were assumed to grow by 10 percent annually in the absence of this measure, then the fee freeze would lower annual fee revenue by about $250 million in the first year, growing to about $1.4 billion in the fifth year.

Summary of Fiscal Effects

This proposal would have the following major fiscal effects:

- Annual increase in state revenues of roughly $2 billion from a new 1 percent tax on high-income individuals. Of these new revenues, 60 percent would be allocated to undergraduate education at the state's public universities and the remaining 40 percent likely would be spent on K-14 education.

- Reduction in public university undergraduate fee revenues (primarily from a five-year freeze on fee levels), potentially exceeding $1 billion by the end of the freeze period.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Michael C. Genest
Director of Finance