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September 2, 2009

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. 09-0023, Amdt. #1-S).

BACKGROUND

The state levies a personal income tax (PIT) on the California income of individuals and noncorporate businesses, such as sole proprietors and partnerships. The rates of the tax range from 1 percent to 9.3 percent, depending upon the taxpayer's income level. An extra 1 percent tax is levied on the portion of taxpayers' incomes greater than $1 million. The PIT allows various deductions from income and credits against any tax owed.

PROVISIONS OF THE INITIATIVE

This measure contains the following main provisions:

Establishes a Wealth Tax. The measure institutes a state wealth tax that levies a 55 percent tax on the net assets of state residents as of January 2010. Because the measure waives the first $6.65 million in wealth taxes owed for single taxpayers ($8.9 million for married couples), the tax would affect individuals with estates of more than $12 million ($16 million for married couples). It appears that the wealth tax would be levied on taxpayers in the state on a one-time basis, with revenues to be deposited in the newly created Environmental Superfund in 2011-12 and 2012-13.

Taxes People When They Die or Leave the State. The measure also imposes a new tax on the income of specified individuals when they die or move out of California. It defines this income to include both income that would ordinarily be reported and any gains in asset values. Individuals with incomes greater than $5 million would be subject

to the tax, and associated revenues would be deposited in the Environmental Superfund. Whether these provisions would impair interstate commerce, and thus violate the United States Constitution, might be subject to court review.

Makes Changes to the PIT. The measure imposes an additional tax under PIT for joint-return taxpayers equal to 17.5 percent of their total taxable incomes if greater than $250,000, with an additional tax of 17.5 percent (for a 35 percent total additional tax) on incomes greater than $500,000. For single taxpayers, these additional taxes would be applied to incomes greater than $150,000 and $350,000, respectively. In addition, the measure establishes several new tax programs that would reduce PIT revenues, including refundable tax credits for: (1) particular designated organizations, (2) the costs of purchasing health insurance for certain individuals, (3) income earned by teachers, (4) higher education tuition and fees, and (5) property tax payments. Any additional net revenues generated by these provisions would be deposited into the Environmental Superfund.

Appropriations. The measure transfers $25 billion from the Environmental Superfund to the General Fund for five consecutive years. Beginning in the sixth year, the measure transfers $10 billion annually from the superfund into the General Fund.

The remaining monies in the newly created Environmental Superfund would be used to acquire a majority interest in outstanding voting common stock of various weapons, petroleum, automotive, media and financial companies, as well as for other environmental protection-related purposes.

FISCAL EFFECTS OF THE INITIATIVE

This measure makes major changes in the state and local tax system. Some of these changes would generate very significant behavioral and economic responses from taxpayers. For example, the taxes on people leaving the state and the additional PIT rates could have a significant negative impact on future economic activity and revenues to the state and local governments. Given factors such as these, the fiscal estimates provided below are subject to considerable uncertainty.

Impact From New Taxes

One-Time Increase From the Wealth Tax. The measure would result in a one-time increase in state revenues (realized in 2011-12 and 2012-13) as a result of the establishment of the wealth tax. The combined increase for both years could be in the range of the low hundreds of billions of dollars. The one-time revenues generated by the wealth tax would be deposited in the Environmental Superfund.

The above estimated one-time revenue effect assumes no behavioral changes on the part of taxpayers. These changes and their impacts on revenues could be very significant, in which case the estimates above would be overstated.

Ongoing Increase From Tax on People Dying or Leaving the State. The revenue gain from the tax upon those dying or leaving the state is unknown, and would depend upon taxpayer behavior, but would potentially result in additional revenues in the billions of dollars annually. These revenues also would be deposited in the Environmental Superfund. This effect assumes no behavioral changes on the part of taxpayers. These changes and their impacts could be very significant, in which case the estimates above would be overstated.

Impact of PIT Changes

Ongoing Revenue Impact. The revenue gain from changes to PIT tax rates would—absent behavioral impacts—result in additional revenues in the range of the high tens of billions of dollars annually. Offsetting these additional revenues would be reductions associated with various tax programs. The largest of these reductions involve the proposed refundable health insurance tax credit, teacher tax credit, and property tax credit. These and other provisions would reduce state revenues (or result in increased expenditures in the case of refundable credits in excess of tax liabilities) in the tens of billions of dollars annually. The net increase of all of the ongoing PIT changes would be potentially in the tens of billions of dollars annually.

The above estimated ongoing revenue effects assume no behavioral changes on the part of taxpayers. These changes and their impacts could be very significant, in which case the estimates above would be overstated.

Impact on the General Fund

The measure would increase General Fund revenues by $25 billion for five years and $10 billion annually thereafter. These funds could be used for any state program. The bill specifically exempts these funds from constitutional spending requirements which typically dedicate a portion of new revenues for K-12 schools and community colleges.

Other Effects

Behavioral Effects. If significant behavioral effects occur that reduce economic activity in California—such as employment, personal income, and investment decisions—then state and local government revenues would be adversely affected. The magnitude of these potential revenue losses is unknown but potentially in the tens of billions of dollars annually.

Summary of Fiscal Effects

The measure would have the following major fiscal effects:

- One-time increase in state revenues potentially in the low hundreds of billions of dollars from imposition of a wealth tax, and ongoing increase in state revenues potentially in the tens of billions of dollars from imposition of the tax on certain people dying or leaving the state and from a higher PIT rate on upper-income taxpayers.
- Increased state general purpose funding of $25 billion during each of the first five years and $10 billion a year thereafter. Remaining revenue would be allocated to purchasing the common stock of various weapons, petroleum, automotive, media and financial companies, as well as for other environmental protection-related purposes.
- Unknown state and local revenue reductions—potentially in the tens of billions of dollars annually—due to changes in taxpayer behavior.

Sincerely,

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Mac Taylor
Legislative Analyst

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Michael C. Genest
Director of Finance