March 12, 2010

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 the treatment under the personal income tax (PIT) of child support payments, as well as the establishment of certain administrative requirements with respect to the Franchise Tax Board (FTB) (A.G. File No. 10-0012).

BACKGROUND

Child Support Payments. Payments for the support of children can be voluntary, privately arbitrated, or court-ordered. Courts order the noncustodial parent to make payments to the custodial parent for expenses related to the child's care in cases where the parents are not living together (due to legal separation, divorce, or other circumstances) and no voluntary support agreement exists. This is intended to recognize that both parents are jointly responsible for the child.

In 2008, there were 1.3 million children in the state whose custodians were owed current court-ordered child support amounting to about $2.6 billion. Of this amount, about $1.4 billion was actually paid, with the remainder considered to be child support debt ("arrearages") and subject to the court enforcement and collection system.

Current Tax Treatment. Current PIT law allows deductions from income for certain items including local taxes, mortgage interest, charitable donations, and extraordinary medical expenses, but not for general living expenses. In particular, expenses associated with children such as food and clothing are not deductible.

MAJOR PROVISIONS

Tax-Related Provisions. The initiative specifies that child support payments are deductible from taxable income and would thus be treated differently from other general child-related expenses.

Administrative Requirements. The initiative contains several tax administration requirements that would affect how FTB handles disputes with taxpayers and how the Department of Child and Social Services (DCSS) handles child support payment arrangements. One significant change is that liens would have to be issued through a court order and with the taxpayer present at the hearing. Currently, FTB can issue such liens administratively.

Other changes include:

- Installment agreements that reduce an individual's income below his/her county's "average standard of living" are restricted.
- All notices to the taxpayer must be delivered by certified or registered mail.
- In the event of dissolution of marriage or other partnership, all tax disputes must be resolved with all parties present.

FISCAL EFFECTS

Revenues

The revenue effect of the proposed deduction for child support payments would depend on several factors including the fraction of child support payers who itemize their deductions, the average marginal tax rate of these taxpayers, and the extent to which deductibility would increase compliance with child support orders. Assuming that "deductibility" would be interpreted as an itemized deduction, the proposal would reduce state General Fund PIT revenue by an estimated $100 million to $200 million per year beginning in 2011-12. This amount would depend in large part on whether the deduction would be subject to an income threshold.

The PIT and child support revenues could also fall due to new administrative requirements on FTB and DCSS, such as restrictions on their ability to impose liens on property. The annual amount of this loss is uncertain and would depend on the legal interpretation of the initiative's provisions, but it could be in the high tens of millions of dollars.

Costs

The initiative's administrative provisions would require increases in both personnel and other operating expenses by FTB. The General Fund cost would depend on how the provisions are both interpreted and implemented, but likely would exceed $10 million annually.

Minor decreases in state welfare administrative costs, resulting from increased child support compliance, may partially offset these costs.

Summary of Fiscal Effects

The measure would have the following major state fiscal effects:

- Reductions in state revenue from administrative changes and the new deduction for child support payments in the low hundreds of millions of dollars annually.
- Annual tax administration costs likely in excess of $10 million.

Sincerely,

Mac Taylor
Legislative Analyst

Ana J. Matosantos
Director of Finance