November 20, 1997

Hon. Daniel E. Lungren
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Rosemary Calderon

Dear Attorney General Lungren:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative entitled *The Corporate Tax Loophole Closure and Individual Tax Refund Act of 1998* (File No. SA 97 RF 0052). This measure would tax corporate profits (as defined) at the same rate as income from wages and salaries, using the single-return tax rate schedule provided for under the state's Personal Income Tax Law. It also would eliminate certain current corporate income tax provisions and reinstitute certain others previously, but not currently, in effect. It provides that any additional net revenues associated with these changes would be refunded to individual taxpayers. In addition, any future tax-related provisions that reduce corporate income tax revenues would need to be approved by a vote of the electorate.

MAJOR PROVISIONS OF THE INITIATIVE

Tax Rate on Corporations

Current Law. Under current law, most corporations are subject to a tax rate of 8.84 percent on their net taxable income.

Proposed Law. Under this measure, corporate profits would be taxed using the single-return tax rate schedule that applies under the Personal Income Tax Law. This rate schedule has six different individual marginal income tax brackets whose marginal income tax rates range from a low of 1 percent to a high of 9.3 percent, depending on a taxpayer's income level.

Elimination and Reinstatement of Various Corporate Tax Provisions

Current Law. Under current Bank and Corporation Tax law, corporations may have their state tax liabilities reduced or eliminated by special beneficial tax provisions, such as exemptions, exclusions, deductions, and credits.

Proposed Law. The proposed initiative defines taxable corporate profits to be taxable corporate income (that is, net income after adjustments for such provisions as tax exclusions, exemptions, and deductions) as specified in the California Revenue and Taxation Code *as of January 1, 1991.* Presumably, this means that any revenue-reducing *or* revenue-raising modifications to taxable corporate income that have occurred since January 1, 1991 would be eliminated. Using this interpretation, the measure also would reinstate components of taxable income (revenue-reducing or revenue-raising) that were in effect on January 1, 1991, but since then have either sunsetted or been repealed or modified.

In addition, the measure states that any temporary suspension of a preferential corporate income tax rate, credit, exemption, exclusion, or deduction in effect as of January 1, 1991 would be made permanent. It also *permanently* repeals or sunsets any preferential income tax rate, credit, exemption, exclusion, or deduction in effect January 1, 1991 subject to repeal or sunset after that date.

Additional Revenues Refunded to Individual Taxpayers

Given that this proposal both eliminates specified beneficial corporate tax provisions and changes the rate at which corporate income is taxed, it will *increase* tax liabilities for many corporations and in some cases by substantial amounts. The initiative also may *reduce* the tax liabilities of some corporate taxpayers because it may reinstate certain beneficial tax provisions or tax these corporations at a rate lower than under current tax law. To the extent that the former effect outweighs the latter, total corporate tax liabilities will be increased, resulting in increased net revenue collections.

Reimbursement Procedures. The proposed initiative requires any additional net revenues collected by the state, as a result of it, to be deposited into a newly created Taxpayer Reimbursement Fund for distribution by the State Controller to individual taxpayers within 30 days after the end of each fiscal year. It provides that additional tax revenues shall be distributed equally among qualifying taxpayers, regardless of their income levels or tax liabilities paid.

Definition of "Taxpayer." For the purpose of giving out refunds, the measure defines a "taxpayer" as any California resident who has reported wage, salary, or pension income to the California Franchise Tax Board during the fiscal year prior to the fiscal year in which a reimbursement/refund is made.

Restrictions to Future Law Changes

The initiative allows the Legislature to change, by majority vote, the definition of corporate income if such changes apply equally to wages and salaries or conform to federal law changes and do not reduce corporate income tax revenues. The initiative states that any law changes reducing corporate income tax revenues or amending the provisions of the initiative would require voter approval.

FISCAL EFFECTS

Impact on State Revenues

This measure would have the following effects on state revenues:

- ***Tax Rate Provision***. Taxing corporate profits at the same rate as wages and salaries under the single-return personal income tax schedule would result in an annual net state revenue gain in the range of $150 million. At the individual corporation level, the effect of this provision on liabilities would depend on income. Corporations with higher incomes would see their liabilities increased due to this provision, and certain others with lower incomes would experience reduced liabilities.

- ***Elimination of Corporate Tax Provisions***. By defining corporate income using a January 1, 1991 base, the measure would eliminate various tax-provision benefits to corporations that have been enacted since that time. The net impact on state revenues would be an annual revenue gain of over $1 billion.

The combined impact of the above provisions on state revenues would be a net annual revenue gain of over $1.1 billion. This gain would result in a comparable amount of money refunded to taxpayers (after reimbursement for administrative costs). Consequently, although aggregate state corporate tax liabilities and collections would be higher, there would be no direct impact on the state budget (including the Proposition 98 minimum funding guarantee for K-14 education).

Restrictions on Future Law Changes. The voting requirements regarding future reductions in corporate tax revenues would make it more difficult to reduce these revenues. This could result in state revenues being *higher* than they otherwise would be at some point in the future, depending on what tax-law changes might have occurred in the measure's absence.

Indirect Effects on Revenues. In addition, there would be various state and local revenue impacts associated with taxpayer behavioral responses. These would include the negative locational and investment responses by corporations facing higher taxes, and the positive spending responses by individuals receiving refunds.

State Administrative Costs

The initiative does not specify a procedure for calculating any additional tax revenues to be transferred to the Taxpayer Reimbursement Fund. Presumably, the appropriate state revenue-collecting agencies would be involved in and incur costs in making this annual calculation. In addition, the State Controller would need to establish a system to verify eligibility of individuals filing claims. State administrative costs would vary depending on how the initiative would be implemented, but could be significant. The initiative provides that these costs would be reimbursed from the additional tax receipts that would be collected. Thus, there would be no net impact on the state.

SUMMARY

The measure would result in an estimated state revenue gain of over $1.1 billion annually due to higher corporate tax liabilities, which would be refunded to taxpayers (no direct impact on the state budget).

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Craig L. Brown
Director of Finance