October 1, 2003

Hon. Bill Lockyer
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Tricia Knight
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative entitled "The Mental Health Services Act" (File No. SA2003RF0036). This proposed statutory measure would enact a state personal income tax (PIT) surcharge that would apply to taxpayers with annual taxable incomes of more than $1 million, the proceeds of which would finance an expansion of community mental health programs.

Background

Community Mental Health System

Counties are the primary delivery system for mental health care in California communities for persons who lack private coverage and need public assistance with their mental health care needs. County mental health systems provide a range of psychiatric, counseling, hospitalization, and other treatment services to patients through various programs supported by a mix of state, local, and federal funding. As part of a realignment of mental health from the state to counties, some state revenues are dedicated by law to the support of county mental health programs and are not subject to annual appropriation in the state budget.

Some county mental health systems help to arrange nonmedical assistance such as housing, substance abuse treatment, and employment services to help their clients. A number of counties have established so-called "systems of care" to coordinate the provision of both medical and nonmedical services for children and adults with mental health problems.

State Personal Income Tax System

The PIT was established in 1935 and is the state's single largest revenue source. It is expected to generate about $34 billion in revenues for the support of state government in 2003-04. The PIT is levied on both residents and nonresidents, with the latter paying taxes on income derived only from California sources. There were more than 14 million PIT returns filed in 2001. The PIT has six tax brackets, with marginal tax rates ranging from 1 percent to 9.3 percent, depending on a taxpayer's income level.

Proposal

New Revenues Generated Under the Measure

This measure provides additional state funding for community mental health programs, in addition to state funding currently appropriated for this same purpose, by establishing a PIT surcharge of 1 percent on taxable incomes in excess of $1 million. The PIT surcharge would be levied on all tax filers beginning January 1, 2005.

Under the initiative, the State Controller would transfer specified amounts of state funding each year on a monthly basis beginning in 2004-05 into a new state special fund, named the Mental Health Services Fund. The monthly amounts transferred to the fund would equal a specified percentage of total PIT receipts that reflects an estimate of the revenues to be received from the surcharge. Upon the calculation of revenues actually received due to the tax surcharge, an adjustment would occur that would reduce or increase the subsequent payments to the special fund such that the revenues deposited in the fund reflected the revenues actually received from the tax surcharge.

How This Funding Would Be Spent

Beginning in 2004-05, revenues deposited in the Mental Health Services Fund would be used for certain new community mental health programs and for the expansion of some existing programs. Specifically, the funds would be used for the following activities:

- New prevention and early intervention programs, including efforts to get persons showing early signs of a mental illness into treatment quickly before they become more severe.
- Expansion of existing system of care services for children who lack other public or private health coverage to pay for mental health treatment.
- A new program to provide technical assistance to counties wishing to establish so-called "wraparound" services providing various types of medical and social services for families where the children are at risk of being placed in foster care.

- Expansion of existing system of care services for adults with serious mental disorders or who are at serious risk of such disorders if they do not receive treatment.
- Stipends, loan forgiveness, scholarship programs, and other steps to (1) address existing shortages of mental health staffing in community programs and (2) help provide the additional staffing that would be needed to carry out the program expansions proposed in the initiative.
- A new effort to provide funding for experimental county programs to improve access to mental health services, including for underserved groups, to improve program quality, or to promote interagency collaboration in the delivery of services to clients.
- A new program to allocate funding to counties for technology improvements and capital facilities needed to provide mental health services.

This measure specifies the portion of funds that would be devoted to particular activities. In 2004-05, most of the funding would be provided for expanding the mental health care workforce and for capital facility and technology improvements. In subsequent years, a larger portion of funding would be used for new prevention and early intervention programs and various expansions of the existing types of services provided directly to mental health clients.

Oversight and Administration. The Department of Mental Health, in coordination with certain other state agencies, would have a lead role in implementing most of the programs specified in the measure through contracts with counties. A new Mental Health Services Oversight and Accountability Commission would be established as a replacement for an existing state mental health grant advisory committee. The new commission would carry out various duties relating to the implementation of this measure including the review and approval of certain county expenditures authorized under this measure. The existing Mental Health Planning Council would have a role in reviewing the performance of community mental health programs. The Franchise Tax Board would be the lead state agency responsible for administration of the tax provisions in this initiative proposal.

Under the terms of the initiative, each county would be directed to draft and submit for state review and approval a three-year plan for the delivery of mental health services within their jurisdiction. Counties would also be obligated to prepare annual updates and expenditure plans for the provision of mental health services.

The measure permits up to 5 percent of the funding allocated annually from the Mental Health Services Fund to be used to offset state costs for implementation of the measure. Up to an additional 5 percent share of the allocations from the special fund could be used annually for county planning and other administrative activities to implement this proposed initiative.

Other Fiscal Provisions

The initiative specifies that the revenues generated from the PIT surcharge be used to expand mental health services and thus could not be used for other purposes. The state and counties would be prohibited from redirecting funds now used for mental health services to other purposes. The state would specifically be barred from reducing General Fund support, entitlements to services, and formula distributions of funds, such as realignment funds, now dedicated for mental health services below the levels provided in 2003-04.

The state would also be prohibited from restructuring mental health programs to increase the share of their cost borne by counties or to increase the financial risk to counties for the provision of such services unless the state provided adequate funding to fully compensate counties for the additional costs or financial risk.

Fiscal Effects

State Revenue Increases. The PIT surcharge would generate new revenues of approximately $250 million in 2004-05, $680 million in 2005-06, $700 million in 2006-07, and increasing amounts annually thereafter. (The impact in 2004-05 is a partial-year effect generated by increased taxpayer withholding, with the first full-year impact occurring in 2005-06.)

State and County Expenditure Increases. If this measure were enacted, the state and counties would incur additional expenditures basically mirroring the additional revenues generated by the surcharge. However, to the extent that revenues generated by the surcharge fluctuated significantly from estimated amounts, there could be shifts of a similar magnitude from year to year in state expenditures. For example, if PIT surcharge revenues were higher than estimated for a particular fiscal year, the payments to the Mental Health Services Fund in a subsequent fiscal year would be adjusted upwards to compensate for the difference.

Funding Reductions Prohibited. Depending upon the state's fiscal circumstances in 2004-05 and subsequent years, some provisions in this measure could result in a higher level of state expenditures for community mental health programs than might otherwise have occurred. As noted earlier, this measure contains provisions that prohibit the state from modifying state General Fund support or making other changes in community mental health programs if such actions would reduce the programs below the 2003-04 level. If the state faced a future budget deficit after this measure were enacted, it would be precluded from reducing the budget or modifying these programs below the 2003-04 level of support and more state funding would be expended for community mental health services than might otherwise have occurred.

State and County Administrative Costs. This measure would result in significant increased state and local administrative expenditures related to the expansion of community mental health services. These costs could amount to several millions of dollars annually for the state with comparable additional costs incurred by county mental health systems on a statewide basis. These administrative costs would be largely offset by the additional revenues generated under this measure.

The state administrative costs associated with the tax provisions of this measure would be minor.

Additional Federal Funds. The expansion of mental health services provided under this initiative—particularly the provisions expanding services for adults who are mentally ill—could result in the drawdown of additional federal funds for community mental health services under the Medi-Cal Program. The amount of additional federal funds is unknown, and would depend upon how the state and counties implement this initiative proposal, but could potentially exceed $100 million annually on a statewide basis.

Partially Offsetting Savings. State and national studies have indicated that mental health programs similar to some of those that would be expanded by this measure generate significant savings to state and local governments that partly offset their additional cost. Studies of such programs in California to date suggest that much of the savings would probably accrue to local government. The proposed expansion of mental health treatment services to several tens of thousands of individuals proposed in this initiative would probably result in savings on state prison and county jail operations, medical care, homeless shelters, and social services programs. The extent of these potential savings to the state and local agencies is unknown, but could amount to hundreds of millions of dollars annually on a statewide basis.

Summary

- Additional revenues of approximately $250 million in 2004-05, $680 million in 2005-06, $700 million in 2006-07, and increasing amounts annually thereafter, with comparable increases in expenditures by the state and counties for the expansion of mental health programs.

- Unknown savings to the state and local agencies potentially amounting to hundreds of millions of dollars annually on a statewide basis from reduced costs for state prison and county jail operations, medical care, homeless shelters, and social services programs that would partly offset the additional cost of this measure.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Steve Peace
Director of Finance