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January 6, 2012

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Dawn McFarland
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed constitutional initiative regarding tuition at state universities (A.G. File No. 11-0086).

Background

Income Tax Rates. The state's personal income tax (PIT) imposes rates ranging from 1 percent to 9.3 percent on the portions of a taxpayer's income in each of six income brackets, with the 9.3 percent rate applying to income in excess of $48,029 for single filers or $96,058 for joint filers. There is an additional 1 percent on income over $1 million that is dedicated to mental health services. The PIT revenue totaled $49.5 billion in 2010-11, accounting for over half of all General Fund revenue.

Public Universities. California has two public university systems: the University of California (UC) and the California State University (CSU). California residents who are eligible to attend these universities pay tuition, among other charges. Tuition levels are set by the governing boards of the universities. For 2011-12, annual tuition is $12,192 at UC and $5,472 at CSU. Student tuition payments cover a portion of the universities' core operating expenses, with the state General Fund covering most of the rest.

Proposal

Income Tax Increase. The measure creates two new PIT brackets starting in tax year 2013: for single filers, 10 percent on income between $250,000 and $500,000, and 11 percent on income in excess of $500,000. For joint filers, the brackets start at $500,000 and $1 million, respectively, and for heads of household they start at $342,465 and $684,930, respectively. These brackets would be indexed for inflation. The current mental health surcharge would remain.

The incremental revenue raised from the two new brackets would be deposited monthly into the newly created Public Postsecondary Tuition Fund, which would be continuously appropriated to the universities. This new revenue would have to be estimated each month, as preliminary and final aggregate income data for each tax year do not become available for another 11 months and 18 months, respectively, after the end of the year. The proposal does not contain a "settle-up" to reconcile differences between estimated and actual revenues (as the mental health tax does).

Tuition Exemption. The initiative exempts resident undergraduate students at UC and CSU from mandatory tuition charges if they (1) attend full time and (2) either maintain at least a 2.7 grade point average or perform 70 hours of community service each year. Students would be eligible for this tuition exemption for up to four years of continuous full-time enrollment.

Replacement Funding for Universities. This initiative replaces UC and CSU's foregone tuition revenue with funding from the Public Postsecondary Tuition Fund. This fund would receive revenues from the increased PITs described above.

Fiscal Effects

Forgone Tuition Revenue. Assuming all students qualify for the tuition exemption and the exemption applies to terms beginning in January 2013, we estimate that UC and CSU together would forgo about $1.5 billion in tuition revenue for the remainder of the 2012-13 fiscal year and $2.8 billion annually thereafter. This amount would grow over time to the extent that university governing boards enacted additional tuition increases.

Tax Revenues. The new income tax provisions would generate about $2 billion or more annually beginning in 2013-14, with a 2012-13 partial year effect of about half that amount. As total income received by upper-income taxpayers is highly volatile, collections could vary considerably from one year to the next. For example, the current mental health tax on income over $1 million generated $734 million in 2009-10 but has raised as much as $1.6 billion in previous years. The new revenues would be used to backfill the loss of tuition revenue to the state universities.

Replacement Funding for Universities. As described above, the tax revenues raised by this measure may not cover the universities' forgone tuition revenues in all fiscal years. In some fiscal years, the universities would have to contend with this revenue reduction through some combination of cost reductions and alternative funding sources, which could create pressure on the state General Fund.

Summary of Fiscal Effects. This measure would result in the following major fiscal impacts:

- Annual loss of state tuition revenue of about $2.8 billion per year beginning in 2013-14, backfilled by additional state personal income tax revenue that is likely to total $2 billion or more per year.
- Potential shortfalls in university resources in some fiscal years would have to be addressed through some combination of cost reductions and alternative funding sources, which could create pressure on the state General Fund.

Sincerely,

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Mac Taylor
Legislative Analyst

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Ana J. Matosantos
Director of Finance