ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Speier	Analyst:	Gloria McConnell	Bill Number:	SB 1940
Related Bills:	See Legislative History	Telephone:	845-4336	Introduced Date:	02/22/02
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Personal Travel Expenses Credit/Business Expense Deduction/100% of Business Meals & Entertainment

SUMMARY

The bill would allow limited special tax treatment for expenses as follows:

- A credit for personal travel expenses, and
- A 100% deduction for business meals and entertainment expenses.

The analyses of the federal/state law, and implementation, technical, and policy considerations for each of these provisions are separately provided below.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to stimulate tourism.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy. Thus, it would be effective immediately. The operative date for the credit and deduction differ, as follows:

- The personal travel expense credit is limited to one tax year only. The credit may be claimed only for tax years beginning in 2003. The expenses subject to the credit for tax year 2003 would be those paid or incurred within 180 days following the enactment of the bill.
- The 100% deductible business expense deduction may be claimed for tax years beginning on or after January 1, 2002. However, the expenses subject to the 100% deduction for the tax year in which they were incurred would be only those paid or incurred within 180 days following enactment of the bill.

POSITION

Pending.

Board Position:			Department Director	Date
______ S	______ NA	______ NP		
______ SA	______ O	______ NAR	Gerald H. Goldberg	03/27/02
______ N	______ OUA	__X__ PENDING		

Summary of Suggested Amendments

As discussed under implementation and technical considerations, amendments may be forthcoming.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit or deduction comparable to those that would be allowed by this bill. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

ECONOMIC IMPACT

Based on the data and assumptions below, order of magnitude revenue effects from this bill are estimated as follows:

Estimated Revenue Impact		
Assumes Enactment On or After June 30, 2002		
For the 180 day Period Beginning on June 30, 2002		
Fiscal Years		
(In Millions)		
	2002-3	2003-4
Personal Travel Credit	Minor*	-$240
Business Meals & Entertainment	-$105	-$15
Total	-$105	-$255

*Minor = less than $1 million.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

The revenue discussion is provided in Attachment A for further information.

PERSONAL TRAVEL CREDIT

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct expenses that are considered ordinary and necessary in conducting that trade or business. Personal expenses are not deductible.

THIS BILL

This bill would allow a credit for “qualified personal travel expenses,” as defined. The credit could not exceed $150 per individual. “Qualified personal travel expenses” would mean expenses that are paid or incurred by the taxpayer: (1) in connection with a “qualified personal trip,” as defined, and (2) during the period beginning on the date the bill is enacted and ending 180 days thereafter. “Qualified personal trip” means any nonbusiness travel by aircraft from the place of the individual’s personal residence to a commercial lodging facility, such as a hotel, motel, resort, inn, or campground.

The bill would not allow the credit for any travel expenses that otherwise would be deductible in connection with a trade or business activity engaged in for the production of income.

Any excess credit could be carried forward to subsequent years.

IMPLEMENTATION CONSIDERATIONS

The department has identified implementation concerns regarding the definitions. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

“Qualified personal travel expenses” describes expenses paid or incurred “in connection” with a qualified personal trip. Under this definition, the following issues may result that may be contrary to the author’s intent:

- gas, repair, and other types of expenses the taxpayer pays for on a car borrowed from friends or family during the qualified personal trip could be eligible to this credit.
- food and other entertainment expenses paid by the taxpayer for the benefit of someone other than the taxpayer (or taxpayer’s dependents) could be eligible to this credit.

“Qualified personal trip” describes a trip “entailing travel by aircraft” from the taxpayer’s “personal residence to a commercial lodging facility.” Under this definition, the following situations may result in the expense being eligible to the credit, which may also be contrary to the author’s intent:

- Taxpayers may travel by car to a location several hours from their personal residence to stay with family members then leave from the airport at that location where there are better air travel connections. It is unclear whether these associated expenses would qualify for the credit.

- The aircraft used for travel may be privately owned and used strictly by the taxpayer (and the taxpayer's dependents). It is unclear whether the author intends for this type of aircraft to qualify or whether the air travel should be made through aircraft commercially hired for the use of the general public.

- While this bill would apply to air travel between the individual's personal residence to a commercial lodging facility, this bill does not require the taxpayer to have paid for the air travel or require the taxpayer stay in and pay for the commercial lodging for a specific period of time. The taxpayer could stay in their second (vacation) home after merely arriving at the commercial facility. Under this scenario, all expenses associated with the stay in the vacation home would qualify for the credit. According to the author's written statement as to what this bill would do, the intent is for the taxpayer to stay a minimum of one night at the commercial lodging facility.

- This provision provides that the qualified expenses be "paid or incurred" (page 2, line 9 and 10) and then subsequently merely requires that the expenses be "incurred" (page 2, line 11). It is unclear whether this is an inadvertent omission of the words "paid or." In any event, in the case of this provision, the word "incurred" may cause confusion and should be replace with "paid." For example, when using the word "incurred," taxpayers could: purchase a refundable airline ticket within the 180-day period, later change their mind, get a full refund, and still be eligible for the credit, merely because the expense was incurred. Or, taxpayers could make reservations for the airline ticket, but then decide against the trip within the 24 hours allowed by the airline and still be eligible for the credit, because the expense was incurred.

- This credit hinges on the expenses of the trip and the 180-day period. It is uncertain whether the personal trip can occur beyond the 180-day period.

- This provision does not limit the number of years for the carryover period. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits typically are exhausted within eight years of being earned.

TECHNICAL CONSIDERATION

- This bill provides that expenses that would otherwise be deductible in connection with a "trade or business activity engaged in the production of income." The correct phrase to identify these expenses consistent with current law is "ordinary and necessary expenses for the production or collection of income."

POLICY CONSIDERATIONS

- This provision would allow nonresident who have personal travel expenses for travel outside California to take this credit against their California income taxes.

- This provision would allow taxpayers to travel by car to an airport outside California to connect with airplane and fly to places outside California, which would not benefit California tourism.

BUSINESS MEAL AND ENTERTAINMENT DEDUCTION

FEDERAL/STATE LAW

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business. However, only 50% of the business-related meals and entertainment expenses is deductible (Section 274(n)(1) of the Internal Revenue Code).

THIS BILL

This bill would allow 100% of business-related meals and entertainment expenses in the taxable year in which the expense is incurred, if within the "qualifying period."

"Qualifying period" means the period beginning on the date this bill is enacted and ending 180 days thereafter. For example, if the bill is enacted July 31, 2002 and the personal travel expense is paid or incurred any time before January 27, 2003, which is 180 days after enactment, the credit for that expense would be claimed on the 2002 or 2003 tax return, depending on when it was incurred.

IMPLEMENTATION CONSIDERATION

It is unclear from the language in the bill whether the expenses that could be deducted under this provision would be limited to those that otherwise would be deductible under the current law except for the 50% limitation. According to the author's written statement as to what this bill would do, these expenses are only those that would otherwise be deductible under existing law except for the 50% limitation. To clarify this intent, the provision could be restructured to provide that the 50% limitation (Section 274(n)(1)) shall not apply during the qualifying period.

TECHNICAL CONSIDERATION

This provision generally provides that the expenses may be either "paid or incurred," thus, recognizing both cash-basis and accrual-basis accounting methods. However, in several places (page 3, lines 5 and 20), the bill only references "incurred." The bill should be amended here to read "paid or incurred."

POLICY CONSIDERATION

This bill would establish a deduction for which federal law has no counterpart, thus increasing nonconformity.

LEGISLATIVE STAFF CONTACT

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Attachment A

REVENUE DISCUSSION

Personal Travel Credit

The impact associated with this bill depends on the number of Californians traveling by air from the place of the personal residence to a commercial lodging facility for personal trips within the 180 days after enactment of this bill. The timing of the impact is based on allowing the proposed credit for travel expenses incurred in 2002 to be claimed for the 2003 tax year.

The projected number of Californians that would benefit from this proposal is approximately 2 million taxpayers and dependents. Information from in-house sources and from the California Department of Tourism was used in this analysis.

Business Meals and Entertainment Expense

The impact associated with this bill depends on the amount of business meals and entertainment expense incurred within the 180 days after the enactment of this bill and the availability of taxable income to offset the expense. Current California law allows a 50% deduction of these expenses, in conformity with federal law. This proposal would allow a 100% deduction of business meals and entertainment expenses for personal and corporate California taxpayers.

This estimate is based on prior federal estimates in this area adjusted for current economic conditions.