Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Corbett	Analyst:	LuAnna Hass	Bill Number:	AB 1118
Related Bills:	See Legislative History	Telephone:	845-7478	Introduced Date:	02-23-2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Seismic Retrofitting Credit

SUMMARY

This bill would allow a credit equal to 55% of the costs of seismically retrofitting a single-family or multiple-family residential structure constructed before 1979.

This bill requires a report to the Legislature.

This analysis will not address the bill's appropriation language, as it does not impact the department or state income tax revenue.

PURPOSE OF THE BILL

The author's office has indicated that the bill's purpose is to encourage seismic retrofitting to minimize the loss of property and loss of life during an earthquake.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective upon enactment and specifies an operative date for the credit provisions for taxable years beginning on or after January 1, 2002, and before January 1, 2007.

POSITION

Pending.

Summary of Suggested Amendments

Amendments 1 through 4 would address the department's technical concerns.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of investment property or property used in a business. The amount of this deduction is determined, in part, by the cost (or basis) of the property. In addition, the property must have a limited, useful life of more than one year. Depreciable property includes equipment, machinery, vehicles and buildings, but excludes land.

Board Position:			Department Director	Date
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Significant improvements to property generally extend the useful life of the property, with the costs increasing the basis of the property and being depreciated over the property's remaining useful life. Ordinary and necessary expenses to repair property used in a trade or business or held for the production of income that do not extend the useful life of such property are currently deductible.

Homeowners are not allowed to deduct expenses to repair a personal residence or to depreciate a personal residence under federal or state law. However, significant improvements may increase the taxpayer's basis in the residence. When the residence is sold, the basis of the residence is used to determine gain or loss to be recognized upon the sale.

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.

THIS BILL

This bill would provide a credit equal to 55% of the amount paid or incurred for any seismic retrofit construction on a single-family or multiple-family residential structure constructed prior to 1979 and located in this state. The seismic retrofit construction costs would be reduced by the amount of any grant provided by a public entity for the retrofit construction. The credit allowed would not exceed $3,000 for each single-family residential structure and $2,500 for each dwelling unit in a multiple-family residential structure. Any unused credit could be carried over for a period of eight years, until exhausted.

Eligibilty for this credit would be limited to the following taxpayers:

For individuals:

- that file single or married filing separate returns with adjusted gross income (AGI) less than or equal to $50,000, or
- that file married filing joint, surviving spouse, or head of household returns with AGI less than or equal to $100,000.

For corporations:

- with California gross receipts, less returns and allowances, reportable to this State, of less than or equal to $1,000,000.

This bill would provide that to qualify for the credit, the seismic retrofit construction of a light wood-frame dwelling with four or fewer dwelling units must comply with Appendix Chapter 6 of the 1997 Edition of the Uniform Code for Building Conservation. In the case of an apartment, condominium, or congregate residence with more than four dwelling units, a licensed architect or registered civil engineer must design the seismic retrofit construction.

To be eligible for this credit, the taxpayer must obtain, retain, and provide to the Franchise Tax Board (FTB) upon request, the certification from the appropriate jurisdiction that the seismic retrofit meets the requirements outlined in the bill. The credit will not be allowed if the taxpayer fails to comply with the certification requirements, unless the failure to comply is due to reasonable cause and not willful neglect.

The term “seismic retrofit construction” is defined as changes or additions to a structure or other attached improvements of a single-family or multiple-family residential structure to mitigate seismic damage. The bill outlines the changes and additions that qualify, although it specifically states that construction activities performed solely to bring a single-family or multiple-family residential structure into compliance with standard local building codes would not qualify.

This bill also would define the terms “single-family residential structure,” “multiple-family residential structure,” and “dwelling unit.”

This bill would require the department, in consultation with the Seismic Safety Commission, to provide a report on the “effectiveness” of the tax credit program, including recommendations regarding the value of continuing the program.

Since this bill does not specify otherwise, the general rules regarding the division of credits among taxpayers that share in the costs would apply. In the case of a pass-through entity (partnership or S corporation), the credit would be allocated according to the general rules for a pass-through entity.

IMPLEMENTATION CONSIDERATIONS

This bill would require the department to provide a report on the “effectiveness” of the tax credit program. Although the department does accumulate and gather statistics related to income tax, it does not have expertise in seismic retrofitting and disaster preparedness. It may be more appropriate for the report to require the Seismic Safety Commission or the Legislative Analyst’s Office to determine the "effectiveness" of the program, with statistical input from the department.

TECHNICAL CONSIDERATIONS

Amendments 1 through 4 are provided to correct various inconsistencies between the two provisions.

LEGISLATIVE HISTORY

SB 677 (McPherson, 2001/02) would allow a credit equal to an unspecified percentage of the final cost of seismic retrofitting to comply with the seismic retrofit building standards for hospitals. This bill is in the Senate Rules Committee.

SB 2051 (McPherson, 1999/00) would have allowed a similar credit as in SB 677 above for corporations. This bill failed passage in the Assembly Revenue and Taxation Committee.

AB 1756 (Scott, 1999/00) would have provided a credit equal to 55% of the costs for seismic retrofit construction on single-family or multiple-family residential structures constructed before 1979. This bill failed passage in the Assembly Appropriations Committee.

SB 875 (Marks, 1995/96) would have allowed a credit equal to 10% of the costs for rehabilitating a residential historic building and 20% for a commercial historic building. This bill failed passage in the Assembly Revenue and Taxation Committee.

SB 1628 (Marks, 1993/94) would have allowed a credit equal to 10% of the costs for rehabilitating historical buildings. This bill was held in the Senate Revenue and Taxation Committee.

OTHER STATES' INFORMATION

A review of *Oregon, Washington*, and *Alaska* tax laws found no comparable credits relating to seismic safety. These states were reviewed because of California seismic activity and the geographic relationship of these states.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Tax Revenue Estimate

This bill would result in revenue losses as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 2001 Enactment Assumed After June 30, 2001 $ Millions			
2001-02	2002-03	2003-04	2004-05
Minor Loss*	-$9	-$12	-$23

* Loss less than $500,000

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

Revenue Discussion

The impact of this bill would depend upon the number of individuals incurring qualifying retrofit expenses and the average credit applied against tax liabilities.

This estimate is based on actual departmental data regarding the previous solar energy credit, and adjusting for differences between the two (i.e., credit limitations, universe of potential taxpayers, difference in qualifying cost, etc.). For purposes of this analysis the solar energy credit was used primarily to determine taxpayer behavior and the credit usage rate. In addition, the following data and assumptions were used:

1. It was assumed that the majority of taxpayers claiming the credit would be located within high earthquake probability counties. According to information from the 1990 U.S. census data, U.S. Geological Survey and various geological studies, approximately 80% of California residential housing is located within high earthquake probability counties. In these counties approximately 32% of the housing was built prior to 1979 (credit applies to seismic retrofit construction on pre-1979 structures).
2. Costs for retrofitting can vary from as low as $1,700, many between $2,000 and $4,000, and few with major complications as high as $10,000 to $12,000.
3. Assumptions were made that approximately one-third of pre-1979 residential housing located in high earthquake probability counties has had some seismic retrofit construction. This assumption is based on construction increases after major earthquakes and assumes that repairs of many damaged houses would have included some seismic retrofit.

ARGUMENTS/POLICY CONCERNS

There may be conflicting tax policies when a credit is provided for an expense item for which preferential treatment is already allowed in the form of a deduction. This proposed credit would have the effect of providing a double benefit for taxpayers that are allowed to deduct the expense of seismic retrofit construction or include the seismic retrofit construction expense in their basis for depreciation. However, eliminating the double benefit by denying the deduction or making an adjustment to reduce basis would create a state and federal difference, which is contrary to the State's general conformity policy.

This bill also would allow a taxpayer receiving the Low-Income Housing Credit to claim both credits on a low-income housing project that is seismically retrofitted. Generally, most credits specify that the taxpayer may claim only one credit on costs that qualify for more than one credit.

For purposes of this bill, “seismic retrofit construction” does not include construction performed solely to bring a single or multiple family residential structure into compliance with local building codes. It is possible that most retrofit construction that is performed today would be made pursuant to local building codes, and therefore would not qualify for the credit in this bill.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1118
As Introduced February 23, 2001

AMENDMENT 1

On page 3, line 13, strikeout "may", and insert:

shall

AMENDMENT 2

On page 3, modify line 29 as follows:

damage, including, but not limited to, the following:

AMENDMENT 3

On page 6, line 12, before "(1)" insert:

(d)

AMENDMENT 4

On page 6, line 37, strikeout "then,"