# ANALYSIS OF ORIGINAL BILL

**Franchise Tax Board**

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| Author: | Leach | Analyst: | Darrine Distefano | Bill Number: | AB 373 |
| Related Bills: | See Legislative History | Telephone: | 845-6458 | Introduced Date: | February 20, 2001 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

**SUBJECT**: Veterinary Expenses for Adopted Animal Deduction

## SUMMARY


This bill would allow a taxpayer to deduct the costs of veterinary services for an adopted animal. It also would allow a veterinarian to deduct expenses for providing certain pro bono services.


## PURPOSE OF THE BILL

The author's staff has indicated that the purpose of this bill is to encourage pet adoptions, thus relieving the overpopulation of animals in shelters.

## EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment and would apply to taxable years beginning January 1, 2002.

## POSITION

Pending.

## ANALYSIS

<u>FEDERAL/STATE LAW</u>

Existing federal and state laws allow individuals to deduct either a fixed amount, indexed for inflation, known as the standard deduction, or the amount of a taxpayer's itemized deductions, whichever is greater. Certain expenses, such as medical expenses, charitable contributions, interest, and taxes, are deductible as itemized deductions. Expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and, like certain other itemized deductions, must exceed 2% of adjusted gross income (AGI) to be deducted as an itemized deduction.

Existing federal and state laws allows businesses to deduct from gross income ordinary and necessary expenses to carry on the trade or business. Some of these expenses include salaries and wages, meals, lodging and travel expenses, advertising, and rental or other payments for use of property.

| Board Position: | | | Department Director | Date |
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Currently, there is no federal or state law that provides any type of tax benefit for adopting an animal from an animal shelter or nonprofit animal welfare organization.

THIS BILL

Under the Personal Income Tax Law (PITL), this bill would allow a taxpayer to deduct expenses for veterinarian services for an animal adopted from an animal shelter or a nonprofit animal welfare organization. The expenses must be paid or incurred within one year of the date of adoption.

Under the PITL and the Bank and Corporation Tax Law (B&CTL), this bill would allow a veterinarian to deduct the expenses paid or incurred in providing pro bono services for an animal adopted from an animal shelter or a nonprofit animal welfare organization. The expenses must be paid or incurred within one year of the date of adoption.

"Nonprofit animal welfare organization" is defined as any organization formed and operated for the primary purpose of preventing abuse, neglect, or exploitation of animals. Such organization also must qualify as an exempt organization under state tax law.

The bill defines "services" to include preventive treatments, such as vaccinations, and the treatment of diseases or illnesses that are preexisting or occurring subsequent to the date of adoption.

IMPLEMENTATION CONSIDERATIONS

To the extent expenses incurred by a veterinarian in providing pro bono services are considered ordinary and necessary business expenses, such expenses are already deductible under current federal and state law. Consequently, this bill would not provide any additional benefit to a veterinarian who incurs expenses in connection with providing pro bono services for adopted animals.

The bill allows a veterinarian to deduct expenses for services provided within one year of adoption. Since the veterinarian is not the party adopting the animal, it may be difficult for both the veterinarian and the department to be certain whether expenses paid or incurred in connection with providing such pro bono services would in fact qualify.

TECHNICAL CONSIDERATIONS

The bill requires the animal welfare organization to qualify as an exempt organization under state tax law. Technically, the wording does not require the organization to have actually applied for and been granted status as a tax-exempt organization. If the author wishes the organization to be a tax-exempt organization, the wording needs minor changes.

**LEGISLATIVE HISTORY**

AB 1139 (Strom-Martin, 1999/2000), died in Assembly Appropriations, would have established the Animal Population Control Fund as a voluntary contribution on the tax return.

SB 430 (Vincent, 2000/2001), currently in the Senate Revenue & Taxation Committee, would provide a credit for spaying or neutering a cat or dog purchased or adopted by the taxpayer.

## OTHER STATES' INFORMATION

Review of Illinois, Massachusetts, Michigan, Minnesota, and New York laws found no comparable tax credits or deductions. These states were reviewed because of the similarities between California income tax laws and their tax laws.

## FISCAL IMPACT

This bill would not impact the department's costs.

## ECONOMIC IMPACT

Based on available information, this proposal is projected to result in minor revenue losses, less than $300,000 annually beginning in 2001-02.

It is projected that 75 percent of the revenue impact would be generated by PIT deductions, subject to the 2 percent of adjusted gross income (AGI) limitation for miscellaneous itemized deductions. Assuming an average medical cost of $250 for those animals requiring medical treatment, the 2 percent AGI limitation would significantly limit the number of people that could claim this deduction. The remaining 25 percent of the estimated revenue loss is projected to be attributable to veterinary services allowed under the proposal, not deductible under current law. This proposal may create limited situations wherein a double deduction is claimed for the pro-bono veterinary services of salaried corporate employees.

The projected number of animals adopted from an animal shelter or nonprofit animal welfare organization in California in 2002 is approximately 200,000. An additional 5 percent of these California adoptions were included for taxpayers adopting animals from out-of-state shelters. Shelters that offer health guarantees for their adopted animals can incur large related medical expenses for adopted animals that become sick within the specified time frame of the health guarantee, usually less than three months. For purposes of this estimate it is assumed that 40% of the projected number of adopted animals will need veterinary services as detailed in this proposal. This revenue loss is computed using an average marginal tax rate of 6 percent.

This estimate was developed in coordination with California experts from animal welfare organizations such as the SPCA and county agencies.

## ARGUMENTS/POLICY CONCERNS

This bill would establish deductions for which federal law has no counterparts, thus increasing nonconformity, which can complicate preparation of a state income tax return.

Conflicting tax policies may come into play in this bill. In the case where a corporation is paying the veterinarian wages for pro bono services, allowing both this deduction and the full amount of wages to be deducted would have the effect of providing a double benefit for that item. On the other hand, making an adjustment to eliminate the wage expense in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general conformity policy.

The deduction would be allowed for veterinarian services either inside or outside California. However, attempting to limit the deduction to California residents or to services provided within California may raise constitutional issues.

## LEGISLATIVE STAFF CONTACT

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