

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Ridley-Thomas Analyst: Gloria McConnell Bill Number: AB 1003

Related Bills: None Telephone: 845-3446 Introduced Date: 02/20/03

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Exempt Organization/Adds Professional Athletic Teams Located in Community Redevelopment Plan Area

SUMMARY

This bill would allow a professional athletic team that is formed in or relocated to a community redevelopment plan area to be exempt from the corporation tax for five years.

PURPOSE OF THE BILL

According to the author, the purpose of this bill is to provide an incentive for a sports team to come to an area in need of economic development.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and apply to taxable years beginning on or after January 1, 2003, except that under the bill it would only apply to a new formation or relocation occurring on or after January 1, 2004.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the implementation concerns discussed in this analysis.

ANALYSIS

FEDERAL/STATE LAW

Under federal and state income tax law, nonprofit organizations, which may be associations, trusts, and corporations, must apply for and be granted tax exemption status. Generally, the first requirement for tax exemption is that the organization must be organized and operated for nonprofit purposes. California's tax exemption laws are generally patterned after federal laws.

California's tax-exempt organizations may be required to file information returns, unrelated business income returns, or corporate income tax returns depending upon the type of organization and tax exempt status.

Board Position:

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Department Director
Gerald H. Goldberg

Date
4/16/03

Existing state tax law provides special tax incentives for taxpayers conducting business activities within economic development areas, as designated by the Technology, Trade, and Commerce Agency (TTCA). These incentives include a sales or use tax credit, hiring credit, business expense deduction, and special operating loss treatment. Economic development areas may be enterprise zones, which focus on economically depressed areas, or Local Agency Military Base Recovery Areas (LAMBRAs), which focus on areas severely economically impacted due to closed or downsized military facilities. These economic development areas are listed on TTCA's website (www.commerce.ca.gov), with details about the programs and the various benefits. California has 39 enterprise zones and eight LAMBRAs.

Overall, the purpose of the Community Redevelopment Law is to supply low and moderate-income housing, expand employment opportunities for jobless, underemployed, and low-income persons, and provide an environment for the social, economic, and psychological growth and well being for the community's citizens. Under this law, local government designates an area it determines to be blighted, as described in Section 33031 of the Health and Safety Code. Local government then may establish a redevelopment project, which is then financed through revenue bond sales. The bonds are repaid through growth in the property tax base due to the redevelopment project. Approximately one-third to one-half of the cities in California has such projects, which are generally monitored by the local property tax assessors. "Community redevelopment plan area" is not specifically defined in the law.

THIS BILL

This bill indicates that for a period of five years following the formation or relocation of a professional athletic team to a "community redevelopment plan area," the team would be exempt from corporation taxes.

"Community redevelopment plan area" is as defined in the Community Redevelopment Law.

IMPLEMENTATION CONSIDERATIONS

According to the author's staff, the professional athletic teams that are intended to be tax exempt under this bill would be organized and operated as profitable organizations. Therefore, to achieve the author's intent, the bill will need to be amended to require FTB to grant tax-exempt status for these organizations, even though they are not organized and operated for nonprofit purposes.

For additional consideration is whether a tax-exempt status for a professional athletic team is the most effective way to achieve the desired tax benefit. A tax-exempt organization typically files an information return rather than a corporate tax return. However, if the organization has income from a business unrelated to its tax-exempt purpose, the organization would file an unrelated business income tax return and is subject to corporate taxes on that income. Unless an organization is subject to corporate taxes, the organization would have no credits, deductions, or operating losses for the five-year, tax-exempt period. Likewise, there would be no resulting unused credits, deductions, or operating losses that could be carried forward for the sixth and subsequent years. This treatment would cause the organization to have significantly different accounting records for state and federal tax purposes.

To allow more consistent state and federal tax treatment and allow the organization to more easily transition into the taxability status in the sixth year, it may be easier for the organization and the department if the bill were amended to instead allow a tax credit. Under this alternative, the organization would be provided a state tax credit equal to the franchise tax that would otherwise be due during the five-year period set forth in the bill. This alternative would result in the organization completing the corporation tax return as usual, claiming all credits, deductions, and operating losses, and then simply claiming the credit in an amount equal to the tax amount required to be shown on the tax return. In the sixth and subsequent years, when the credit has expired, the organization would apply any unused credits, deduction, or losses from the previous year against the taxes that would be due in the sixth year.

Of additional consideration is that “community redevelopment plan area” is not specifically defined in the law. Therefore, it may be difficult for FTB staff to know if a team is newly formed or has relocated in such an area. This bill could be more easily administered if the local government that designates a community redevelopment plan area were required to issue a certification to the team that it is eligible for the tax exemption provided by this bill. The team could then furnish the certification to FTB upon request.

“Formation,” “relocation,” “newly formed,” and “relocated” are undefined. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill.

OTHER STATES’ INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws were reviewed due to their similarities to California's economy, business entity types, and tax laws. Review found that property tax exemptions and bond issuances have been provided for the construction of sports facilities/complexes (e.g., raceways, baseball parks, stadiums), however, no laws were found for an income tax exemption or credit for the team itself.

FISCAL IMPACT

Departmental Costs

If this bill is amended to resolve the implementation considerations addressed in this analysis, the bill would not impact the department’s costs.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of the bill would be determined by the number of teams that are newly formed in, or relocated from another state to, a community redevelopment plan area, and amounts of net income for state tax purposes that would otherwise be taxable. Although a specific estimate cannot be derived, potential revenue losses would be very significant over time, perhaps on the order of tens of millions of dollars over the initial five-year period of this bill.

Tax Revenue Discussion

Currently, the NFL, NBA, NHL, and MLB consist of 121 teams, of which 15 are located within California. These large market teams, and an even greater number of small market teams (e.g., minor league baseball), plus the professional teams of other sports such as motor vehicle racing, horse racing, team tennis, bicycling, etc. potentially would qualify for exemption under this bill. And with league expansions, the number of teams will only increase in future years.

For professional athletic teams, revenue streams come from several sources: television and other broadcast rights, attendance, merchandising, stadium naming rights, etc. As professional athletics is big business, these revenue streams are very substantial, if not staggering, in amounts. Available information regarding past team moves suggests that huge sums of tax revenue would go potentially untaxed during the five-year exemption proposed in this bill.

ARGUMENTS/POLICY CONCERNS

The bill requires only that the team be “newly formed in or relocated from another state” to a community redevelopment plan area. Therefore, potentially the team’s ticket office, administrative office, or training facilities may be newly formed or relocated in a community redevelopment plan area, and yet the team would still be eligible for the tax exemption provided by this bill, which may not be the author’s intent.

The bill would provide the tax exemption “for the period of five taxable years following the teams’ formation or relocation.” There have been cases where it may take several years from the time a franchise for a team is granted and the first game is played. In these cases, it is uncertain whether it is the author’s intent to have the five-year window begin from the granting of the franchise, the first game, or some time in between.

This bill would limit the tax-exempt status to corporations, thereby, creating an inequity for professional athletic teams owned by partnerships or individuals.

Typically, under tax law, taxpayers that move or relocate outside the targeted area within a given time frame may be required to add all or a portion of the tax benefit back (recapture) to the tax liability amount. This bill does not contain a recapture provision.

Allowing an income tax exemption to a business organized and operated for profit is unprecedented.

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