Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Leno	Analyst:	Darrine Distefano	Bill Number:	AB 1187
Related Bills:	See Legislative History	Telephone:	845-6458	Amended Date:	July 15, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Local Vehicle License Fee Deduction/City & County of San Francisco/FTB Report To Controller Amount Of Revenue Loss & Costs Incurred By FTB

SUMMARY

This bill would do the following:

- Allow the City and County of San Francisco to impose a local vehicle license fee (VLF) on its residents who operate a vehicle in San Francisco,
- Require the Franchise Tax Board (FTB) to include space on income tax returns to report the local VLF, and
- Require FTB to report the total amount of revenue lost to the state from deductions for the local VLF to the State Controller (Controller).

The provisions related to the imposition of the local VLF are only discussed to the extent they impact FTB.

SUMMARY OF AMENDMENTS

As introduced, February 21, 2003 and amended April 29, 2003, this bill would have established a redevelopment area for the Hunters Point Shipyard and established a Hunters Point Shipyard Development Authority.

As amended June 10, 2004, this bill removed the provisions relating to the redevelopment area and inserted provisions to allow the City and County of San Francisco to impose a local VLF on its residents.

The July 15, 2004, amendments added the provisions that will be discussed in this analysis.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to raise additional funds for fire, health, and public safety for the City and County of San Francisco by implementing a local VLF.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2005. Since the local vehicle license fee would need to be approved by the voters, it is assumed that a measure would be placed on the November 2005 ballot. If approved, the bill addresses returns filed for the 2006 taxable year.

Board Position:			Department Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Gerald H. Goldberg	8/17/04
_____ N	_____ OUA	__X__ PENDING		

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current state law allows the state to impose a VLF on its residents in lieu of a property tax on vehicles. The formula for VLF assessment established by the Legislature is based upon the purchase price of the vehicle or the value of the vehicle when acquired. The amount of the VLF decreases with each renewal for the first 11 years.

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions.

Under current state and federal law, the VLF is considered a personal property tax that is deductible. For personal income taxpayers, unless the vehicle is used in a trade or business, the VLF is deducted as a personal property tax on the federal Schedule A - Itemized Deductions.

Federal and state law defines personal property tax as an ad valorem tax that is imposed on an annual basis in respect of personal property. The VLF imposed by the state or a local government is considered such a tax.

For businesses, the VLF is deducted as a business expense and is deducted against business income.

THIS BILL

This bill would allow the City and County of San Francisco to impose a local VLF on its residents who operate a vehicle in San Francisco. This local VLF would be in addition to the current state VLF.

This bill would require FTB to add a line to state income tax returns for taxpayers to report the local VLF that was paid or incurred during the taxable year.

This bill would require FTB to report to the Controller the following information:

- The total amount of revenue loss for deductions taken as a result of the local VLF under the Personal Income Tax Law (PITL) and the Corporation Tax (CTL), and
- The total amount of costs incurred by FTB to do the following:
    - Determine and report the amount of revenue loss, and
    - Revise the tax return to report the deduction taken for the local VLF.

This bill would require the Controller to do the following once a report is received from FTB:

- Reduce the total amount of revenue that would have been deposited to the Motor Vehicle License Fee Account by the amount of revenue loss from deducting the local VLF.
- Reduce the total amount of revenue that would have been allocated to the City and County of San Francisco by the amount of revenue loss and the amount of FTB's costs to revise the forms and make required reports.

The following chart illustrates what this bill would do and includes the revenue impact:

Local VLF imposed on residents who operate a vehicle in the City and County of San Francisco

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Local VLF is deductible from income

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Taxpayers that can itemize or expense the local VLF would derive a tax deduction benefit; those that use the standard deduction would not derive a tax benefit.

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Reduced income tax revenue to the state due to the additional income tax deductions

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FTB reports to the Controller the following:

- Revenue loss to the state for the tax deduction benefit
  - 2006-07 = $4 million; 2007-08 = $3 million; 2008-09 = $3 million
- Departmental administrative costs incurred
  - $1.5 - $3.5 million

↓

Controller reduces the funds by the amounts described above:

- The revenue deposited in to the Motor Vehicle License Fee Account in the Transportation Tax Fund
- Revenue required to be paid to the City and County of San Francisco from the Motor Vehicle License Fee Account in the Transportation Tax Fund

IMPLEMENTATION CONSIDERATIONS

The author's office has indicated that the bill language does not meet the author's intent. Department staff is currently working with the author's office to ensure department's concerns for subsequent amendments are addressed.

This bill would have a significant impact upon the department. As described below under "Fiscal Impact," the department would incur costs to change the tax forms, instructions, and booklets and to program, test, and maintain departmental systems. Department staff has identified the following implementation considerations for purposes of a high-level discussion. Additional concerns may be identified as the bill moves through session.

- This bill would require FTB to include a line on PITL and CTL tax returns for the taxpayer to report the local VLF. A local VLF is eligible under current law to be included as an itemized deduction either as personal property tax or as a normal business expense. Accordingly, this bill could be interpreted to allow taxpayers an additional deduction thus providing a double benefit. It could also be interpreted to allow a deduction for the local VLF whether or not a taxpayer claims itemized deductions. The author's office has indicated that this is not their intent.
- It is not clear if FTB would need to verify with Department of Motor Vehicles (DMV) the amount of deduction reported on income tax returns by taxpayers. Since FTB would be responsible for reporting the total amount of deductions taken by taxpayers to the Controller, if the amount transmitted to San Francisco by DMV is significantly higher or lower than the amount reported to Controller, it is not clear how amounts would be reconciled. Without some type of data exchange between FTB and DMV, a discrepancy in the amounts taken from the Transportation Tax Funds could result.
- Under current law, taxpayers can use an address other than their residence address on their tax return. A taxpayer may use a post office box, their business address, the address of their tax preparer, or the address of a friend or relative. In order to administer the tax program outlined in this bill effectively, each taxpayer would need to provide their correct residence address on their tax return.
- Individual expenses taken as itemized deductions are combined and totaled on a separate schedule. The taxpayer then enters the total on the tax return. These individual expenses are not entered into the FTB systems. In order to report the local VLF amount, the department would likely be required to add a line to all of the PITL and CTL income tax returns where the tax would be deducted. Adding an additional line for information purposes only for San Francisco taxpayers could cause confusion for approximately 14 million California taxpayers.
- In addition, the taxpayer would be required to separate the local VLF amount from the state VLF for purposes of reporting on the return, which could cause further confusion. This could further increase discrepancies in the Transportation Tax Funds if taxpayers fail to separate the state VLF from the local VLF.

TECHNICAL CONSIDERATIONS

This bill reduces the amount allocated from the General Fund to San Francisco by FTB's costs but does not specify that FTB be reimbursed by the Controller for the costs incurred. The bill should include language to clarify that FTB be reimbursed for determining and reporting the total amount deducted for the local VLF and for revising the tax return.

The bill's language is not clear regarding the timing of the reporting of the information from FTB to the Controller. Assuming the local VLF would be imposed beginning January 1, 2006, this bill would require FTB to report the revenue loss for 2007 by January 15, 2008. FTB would only have 2006 tax year information available, not 2007. This two-year delay could cause discrepancies in what is taken from the Transportation Tax Funds. The author may wish to amend the language to clarify the timing of the report with respect to FTB processing and to ensure the correct amounts are reported.

LEGISLATIVE HISTORY

AB 1690 (Leno, 2003/04) would give FTB the authority to administer and collect a local income tax approved by the voters. This bill also has provisions regarding public safety finance agencies and property taxes. AB 1690 was held in the Senate Appropriations Committee.

FISCAL IMPACT

Below is a general description of additional work that would be required by the department beyond the normal annual system update in order to fulfill the reporting requirement for the local VLF:

- FTB could incur significant system programming hours. This information would need to be captured and processed in order for it to be reported to the Controller. FTB could be required to create a new database, codes, and processes to capture the information. FTB would have no other use for the database and processes beyond reporting the information to the Controller. Maintenance and updates to a database that is used only for this purpose could redirect department resources away from other revenue generating projects and annual updates.
- All items on the tax return are either added or subtracted in order to calculate the tax due or refund. Depending on where the local VLF line is located on the return, taxpayers may mistakenly add or subtract this amount adversely affecting either their tax due or refund. As a result, additional notices would be sent to taxpayers for either a reduced refund or additional tax due. Under normal circumstances, these taxpayers would not need to be contacted further if no errors occurred on the return.
- Although instructions would be provided in the Personal Income Tax booklet, FTB anticipates an increase in taxpayer contacts for assistance in reporting the local VLF or corrections to their return.

Until an implementation plan is fully developed, departmental costs cannot be determined. For discussion purposes, staff looked at 1) the San Francisco population that filed a tax return in the 2001 tax year 2) potential increased customer contact and notices, and 3) basic processing functions and systems that would need to be modified to incorporate the reporting of the local VLF, and made some cursory cost calculations. Based on these calculations, staff estimates that the preliminary department costs could range from $1.5 - $3.5 million to implement this bill. As the implementation plan is further developed and in the event this bill is amended, department costs will be revised.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

The estimate below describes the tax revenue impact from income tax deductions, which would be the approximate amount that would need to be reimbursed to the General Fund. This bill would require the General Fund to transfer less money as a result of the local VLF revenue to the City and County of San Francisco because of the tax revenue impact and FTB's administrative costs.

As stated under "Technical Considerations" above, because of the timing of the report to the Controller, the General Fund would be reimbursed about a year behind that report.

Based on data and assumptions discussed below, this bill would result in the following PITL and CTL tax revenue impact:

Estimated Tax Revenue Impact of AB 1187 As Amended 7/15/04 [$ In Millions]			
2005-06	2006-07	2007-08	2008-09
Negligible	-$4	-$3	-$3

Negligible loss is less than $150,000. Estimates assume the ordinance is voter approved in November 2005, and is imposed beginning January 1, 2006. Based on this assumption, the proposed local fee would be deducted initially on the 2006 tax returns that are filed in 2007.

Revenue Discussion

The revenue impact of this bill would be determined by the amount of additional vehicle license fees deducted on tax returns and the tax rates of taxpayers deriving a tax deduction benefit.

As calculated, the amount of the local VLF fee would be equivalent to the current VLF offset. Using data available from DMV with respect to fees paid for vehicle registrations in San Francisco County by vehicle type, the average VLF offset per vehicle type are projected as follows:

Vehicle Type	**Projected Number of Vehicle Registrations in 2006**	**Average VLF Offset Per Vehicle in 2003**
Autos	428,590	$156
Trucks	70,710	$135
Trailers	13,800	$89
Motorcycles	21,000	$71

Multiply the number of vehicle registrations by the average VLF offset and summing the results derives a total local VLF of $79.1 million for San Francisco City and County.

[428,590 x $156 = $66.9 million]
[70,710 x $135 = 9.5 million]
[13,800 x $89 = 1.2 million]
[21,000 x $71 = 1.5 million]
Total local VLF = $79.1 million

If 50% of the $79.1 million results in a tax deduction benefit to PITL and CTL taxpayers, applying a 7% tax rate derives an annual tax loss of approximately $3 million. [$79.1 million x 50% x 7% = $2.8 million]. The number of fee-paid vehicle registrations grows at about 3% each year. Estimates assume the average VLF offset remains constant.

It is assumed that few taxpayers would adjust their estimated tax payments for this additional deduction in the year the fee is initially imposed. Therefore, the revenue loss for 2005-06 is projected to be negligible (less than $150,000). The $4 million loss for 2006-07 reflects the loss from 2006 and a portion of losses from 2007. The portion of losses from 2007 reflects taxpayers adjusting their estimated tax payments.

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