Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	La Suer	Analyst:	Kristina E. North	Bill Number:	AB 2597
Related Bills:	None	Telephone:	845-6978	Introduced Date:	February 20, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Vehicle License Fees/Prepayment

SUMMARY

This bill would allow prepayment of the vehicle license fee (VLF).

PURPOSE OF THE BILL

The purpose of this bill is to increase immediate revenues for the state by allowing the prepayment of the VLF.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative immediately upon enactment.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, such as the vehicle license fee, as itemized deductions.

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.

Under current federal and state tax law, different accounting methods exist. The most common methods are the cash method, used by most individuals and many small businesses, and the accrual method. Under the cash method, all items of income actually or constructively received during the tax year must be included and expenses are deducted in the tax year in which they are paid. Under the accrual method, income is reported in the year earned and expenses are deducted or capitalized in the year incurred. Under these accounting methods, an expense you pay in advance is deductible only in the year to which it applies, unless the expense qualifies for the 12-month rule. Under the 12-month rule, a taxpayer is not required to capitalize amounts paid to create certain rights or benefits for the taxpayer that do not extend beyond the earlier of the following:

- 12 months after the right or benefit begins, or
- The end of the tax year after the tax year in which the payment is made.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Gerald H. Goldberg	4/28/04
_______ N	_______ OUA	___X___ PENDING		

Under current state law, the 2% VLF is a personal property tax on vehicles. The VLF is based upon the sale price or vehicle value when initially registered in California. The VLF is calculated by rounding the sale price to the nearest odd hundred-dollar amount. The amount is reduced by a percentage utilizing an 11-year schedule, and 2% of that amount is the fee charged. Currently, there is a 67.5% offset for VLFs due on or after July 1, 2001. For example, if the purchase price of a vehicle was $23,595, rounded to 23,500, multiplied by 2% equals $470, minus the 67.5% offset ($317.25) equals a $152.75 VLF for the registration year following the year of purchase.

THIS BILL

This bill would allow a taxpayer to prepay the VLF for up to four years. The taxpayer would receive a discount on the VLF amount depending on the number of years prepaid. The taxpayer could receive a discount from 10% to 20% of the VLF for the prepayment of two to four years.

In the event the taxpayer sells the vehicle or leaves the state, the taxpayer would not be allowed to obtain a refund of the prepaid taxes. If a taxpayer sells a vehicle with a prepaid VLF, the new owner would not be required to make any VLF payments until the prepayment period expires.

In the event of a constructive total loss or the theft of a vehicle with a prepaid VLF, this bill would allow a taxpayer a refund or credit against the prepaid VLF owed on the taxpayer's replacement vehicle.

IMPLEMENTATION CONSIDERATIONS

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

This bill does not provide language that would resolve disputes between FTB, the seller, and a buyer of a vehicle with prepaid VLF. For example, a dispute could arise where a buyer claims that a portion of the amount paid for the vehicle includes reimbursement of the seller's prepaid tax so that portion of the purchase price is deductible by the buyer, and the seller claims that the amount paid for the vehicle does not include any reimbursement of prepaid VLF so that the seller doesn't have to report any portion of the amount received as income. The author may wish to consider adding language that for the purposes of Revenue and Taxation Part 10 or 11, a buyer of a vehicle with prepaid VLF may not be considered to have paid VLF, or in the alternative, the seller will be considered reimbursed for the amount of prepaid VLF.

This bill specifies that a taxpayer may elect to prepay tax obligations "incurred" under the Revenue and Taxation Code. Since the tax obligation is not "incurred" until the year it is due, it is unclear if a taxpayer could be held liable for any future statutory increases in the VLF amount or receive a refund for any statutory decreases in the VLF from the amount prepaid.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York*, which do not provide a prepayment of VLF comparable to the prepayment allowed by this bill. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

If the implementation considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would have the following revenue impact.

Estimated Revenue Impact of AB 2597 As Introduced February 20, 2004 [$ In Millions - rounded]		
2004/2005	2005/2006	2006/2007
-$1	-$15	-$3

Tax Revenue Discussion

The revenue impact of the bill would be determined based on the number of prepaid VLFs deducted on tax returns under the bill compared to VLFs deducted under current law, and the marginal tax rates of taxpayers deducting VLFs. The revenue impact of this bill is contingent on the number of vehicles in California, the ages of those vehicles, and their most recent sales prices.

Allowing for scrappage and for vehicles entering and leaving California, the total number of fee-paid registrations (autos, trucks, trailers, and motorcycles) is estimated at 29.1 million for 2003/2004. According to the Governor's Budget Summary, total VLF revenue is projected at $1.3 billion for 2003/2004. For 2004/2005, the Governor's Budget Summary estimates a 3% increase, or 29.9 million fee-paid registrations, with total projected VLF revenue of $1.5 billion. Dividing the VLF revenue by the total number of fee-paid registrations derives an average VLF per registration of $50 in 2004/2005. [$1.5 billion divided by 29.9 million = $50 VLF].

If taxpayers prepay VLFs for an average of three years, assuming the current year plus two additional years, with the proposed 15% discount, the average prepayment per registration would be $127.50. If taxpayers prepay this average VLF for one in ten vehicle registrations and three-quarters of these taxpayers derive a tax deduction benefit, accelerated deductions would total $285 million. Reducing the $285 million by the projected amount of VLF deductions under current law ($100 million) would generate a net accelerated deduction of $185 million. Applying an average tax rate of 8% derives a $14.8 revenue effect for one full year. [29.9 million x 10% = 2.9 million x 75% = 2.2 million x $127.5 = $285 million - $100 million = $185 million x 8% = $14.8 million]

It is assumed that DMV implementation would be completed by January 1, 2005, for vehicle registrations due on that date and thereafter. It is assumed that few taxpayers would adjust their estimated tax payments to reflect an accelerated deduction. The revenue impact for 2004/2005 is projected to be 10% of the total for the first six months of 2005, or approximately a $1 million loss. For 2005/2006, the revenue impact is estimated at $15 million. For 2006/2007, revenue losses diminish to a level of $3 million because of the timing of deductions under the proposal (accelerated) compared to deductions under current law. It is assumed that making a VLF prepayment does not relieve taxpayers of the requirements for providing proof of insurance and obtaining a smog test.

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