Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Nation	Analyst:	John Pavalasky	Bill Number:	AB 848
Related Bills:	See Legislative History	Telephone:	845-4335	Introduced Date:	February 20, 2003
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Impose California PITL & CTL Tax Equal To Federal Tax Benefit From Electing To Expense Certain Depreciable Business Assets & Exception To Limitation On Depreciation

SUMMARY

This bill would impose a new California tax equal to the federal tax benefit derived by any taxpayer's election to currently deduct or rapidly write-off the cost of assets that would otherwise be depreciated.

PURPOSE OF THE BILL

According to the author's office the purpose of the bill is to not allow a new federal tax benefit for purchasing a large passenger sport utility vehicle (SUV) over a more fuel-efficient vehicle.

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.

POSITION

Pending.

Summary of Suggested Amendments

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

ANALYSIS

FEDERAL/STATE LAW

Current Federal Law

On the federal tax return a corporate or noncorporate taxpayer (other than estates, trusts, or certain noncorporate lessors) may elect to treat the cost of qualifying property (called Section 179 property) as a current expense rather than being required to depreciate the property over a number of years. The maximum deduction for 2003 and later years is $24,000.

Board Position:			Department Director	Date
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This maximum deduction is reduced, on a dollar for dollar basis, once assets costing more than $200,000 have been placed in service by the taxpayer during the taxable year. This reduction is the mechanism used to target the benefit to small businesses.

Federal law also contains rules (called the luxury car limits) that limit the amount of depreciation or Section 179 expensing that can be deducted each year for certain passenger vehicles. These luxury car limits apply to leases of passenger vehicles by requiring an amount be added to income in each year of the lease (using tables issued by the Internal Revenue Service) based on the fair market value of the vehicle for that year. For purposes of the luxury car limits, a passenger vehicle is any four-wheeled vehicle manufactured primarily for use on public streets, roads, and highways that has an *unloaded* gross vehicle weight (i.e., curb weight fully equipped for service but without passengers or cargo) of 6,000 pounds or less. However, a passenger vehicle includes a truck or van (including a SUV or minivan) if it has a gross vehicle weight (i.e., maximum total weight of a *loaded* vehicle as specified by the manufacturer) of 6,000 pounds or less. Consequently, some large passenger SUVs are not subject to the luxury car limits.

Current State Law

California is conformed to the federal Section 179 deduction and the luxury car limits for noncorporate taxpayers and S corporations, but requires corporations to depreciate these assets over a longer period of time than under federal law. The depreciable lives of corporate assets vary by type of asset.

<u>THIS BILL</u>

This bill would impose an additional California tax on corporate and noncorporate taxpayers equal to the federal benefit derived from the full Section 179 deduction and the exemption from the luxury car limits.

<u>IMPLEMENTATION CONSIDERATIONS</u>

The intent statement contained in the bill indicates that the federal benefit being targeted is the incentive given under federal law for a business to purchase SUVs. That statement also states that the new California tax would be imposed only if the federal incentive is increased from $25,000 to $75,000. However, the statutory language for the imposition of the new California tax is not dependent on either of those intent statements.

It is unclear how this tax would impact pass-through entities such as partnerships and limited liability companies (LLCs) classified as partnerships that are required to make the federal Section 179 election on behalf of their partners or members, even though the tax benefit is derived by an individual or corporate partner or member of the LLC.

It is also unclear how much of the federal benefit would be attributed to a corporation doing business inside California and also in other states or countries.

Under the federal rules for Section 179, that deduction cannot be used to create a net operating loss for the year. The excess deduction is carried forward to the following year and deducted on the return for the following year. It is unclear whether the California tax would be equal to the full Section 179 amount or only the portion deducted on the return for the year the asset was acquired.

TECHNICAL CONSIDERATIONS

On page 2, lines 35 and 37, the bill is adding Section “23151.1” to the Revenue and Taxation Code. However, Section 23151.1 is already an existing provision within the Revenue and Taxation Code. The bill needs to be amended to select an unused number, such as Section “23151.4.”

LEGISLATIVE HISTORY

This is the first bill imposing a California tax on a federal tax benefit received by the taxpayer.

OTHER STATES’ INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws. None have a tax comparable to the tax imposed by this bill.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved but are anticipated to be significant.

This bill would require a calculation for the tax that would require a new form or worksheet to be developed. As a result, this bill would impact the department’s printing, processing, and storage costs for tax returns. The additional costs have not been determined at this time. If the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested.

ECONOMIC IMPACT

Revenue Discussion

It is not possible to project in advance the response of taxpayers that would elect the Section 179 deduction and utilize the exemption from the luxury car limits, if California could legally/constitutionally impose a tax equal to the federal tax benefit received. Any net tax benefit the taxpayer would receive at the federal level as a result of the Section 179 deduction and utilizing the exemption from the luxury car limits would be offset at the state level in the first year. The overall net impact, due to depreciation reductions, would be an increase in the taxes for the taxpayer in the following and future years. Therefore, if enforceable, it is not anticipated that many taxpayers would elect the Section 179 deduction and utilize the exemption from the luxury car limits for federal purposes.

LEGAL IMPACT

This bill would impose the tax on California residents, nonresidents, and all corporations receiving a federal tax benefit. This may be unconstitutional since it would discriminate against nonresidents and corporations with California source income who are required to file a state tax return but would not take into account that the business income may have less than 100% connection to California.

ARGUMENTS/POLICY CONCERNS

This new California tax could be viewed as intending to impose a tax on the purchase by a business of a large passenger SUV of approximately 34% for corporations and approximately 31% for noncorporate businesses. Those percentages represent the approximate federal tax rate imposed on these businesses. It would be much simpler for taxpayers to determine the California tax at the time of initial registration and for the State Board of Equalization to administer a direct tax on the purchase of the targeted large passenger SUVs. That tax could be withheld and remitted at the time of purchase, as is currently done with regard to the sales tax, rather than at a time up to two years after the purchase (i.e., upon the filing of the tax return for the year of purchase).

The federal Section 179 expensing deduction allows the taxpayer to choose the assets that are to be expensed in the year acquired rather than depreciated. Thus, a taxpayer may simply choose different assets to expense and avoid that portion of the federal benefit being taxed under this bill. The large passenger SUVs purchased could, thus, still be fully depreciated and receive federal tax benefits but not be subject to the new tax.

This bill does not contain any estimate penalty relief for the increase in tax required by this bill even though the bill would not be enacted until after at least one estimate payment would be required to be increased for the taxable year.

This bill does not propose to change the state benefits from the deductions allowed under Section 179 to individuals and S corporations on the state tax return. This may be viewed as inequitable.

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