Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Battin	Analyst:	Jane Tolman	Bill Number:	SB 1561
Related Bills:	See Legislative History	Telephone:	845-6111	Amended Date:	March 22, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: National Guard Armory Credit

SUMMARY

This bill would provide a tax credit for taxpayers that donate property to the California National Guard.

SUMMARY OF AMENDMENTS

The March 22, 2004, amendments added a provision that would allow the credit to apply against corporate income taxes and specified a credit percentage of 100% of the fair market value of real and personal property (including cash) donated.

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

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to provide a funding source for the construction, maintenance, and refurbishment of California National Guard armory facilities.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 2004, and before January 1, 2009.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Board Position:			Department Director	Date
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Existing state and federal laws allow itemized deductions for charitable contributions. Under certain circumstances an individual is allowed to deduct the fair market value of the property being contributed, subject to an overall limitation that an individual can only deduct an amount not to exceed 50% of their adjusted gross income. Should the contribution amount exceed that percentage limitation, the amount of the deduction in excess of the limitation may be carried over and deducted in future years.

THIS BILL

This bill would provide a tax credit for donating property to the National Guard. The credit would be equal to 100% of the qualified amount donated.

"Qualified amount" means the fair market value of the donated property, including real property. The donation must be for the purpose of constructing, maintaining, or refurbishing a California National Guard armory facility.

Any credit that exceeds the taxpayer's tax liability could be carried over indefinitely.

This credit would be repealed as of January 1, 2010.

IMPLEMENTATION CONSIDERATIONS

This bill does not provide a detailed definition for "qualified amounts" and what can be donated. The author may wish to be more specific to ensure that the items donated could be used for construction, maintenance, or refurbishment. As written, property and real property could include almost anything, including money. The author's office has indicated that cash is an acceptable donation. A detailed explanation of what is acceptable donation would reduce confusion for the taxpayer.

This bill does not require the donation to be specifically for use in the construction, maintenance, or refurbishment of the armory facility. The author may wish to place requirements in the language of how the donations must be used.

This bill would not require the taxpayer to recapture the credit in the event the donations were returned to the taxpayer.

This bill does not limit the number of years for the carryover period. The department would be required to retain the credit on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits typically are exhausted within eight years of being earned.

By providing a tax credit for a charitable donation, this bill would allow taxpayers to claim multiple tax benefits for the same item of expense. Providing both a credit and a deduction for the same charitable donation would have the effect of providing a double benefit. The author may wish to add language stating that the credit would be in lieu of any other deduction that may be allowed for the charitable donation.

Department staff is available to work with the author's office to resolve these and other concern that may be identified.

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.

Illinois, Massachusetts, Michigan, Minnesota, *New York,* and *Florida* laws do not provide a credit comparable to the credit allowed by this bill.

FISCAL IMPACT

Once the implementation concerns are resolved, this bill would not significantly impact the department's costs.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

The revenue impact of this bill, as amended would be a $220 million loss of Personal Income Tax (PIT) revenue and an additional impact of 10% for corporations beginning in 2004-05.

	2004-05	2005-06	2006-07
Personal Income Tax	$220 million	$220 million	$220 million
Corporation Tax	$22 million	$22 million	$22 million

A 100% nonrefundable credit for cash and non-cash contributions is assumed with enactment after 6/30/04.

<u>Revenue Discussion</u>

It is estimated that a 100% tax credit would result in a PIT revenue loss of over $220 million annually due mainly to redirected cash donations. Individual taxpayers donated over $18 billion in total charitable contributions for 2001. Based on federal data approximately 6% of those donations were for social/public benefit charities. If it were assumed that 20% of those donations would be redirected to California National Guard armories, the PIT revenue loss would be $220 million annually ($18 billion x 6% x 20% x 100% = $220 million).

Since it cannot be determined in advance how many taxpayers would make cash and non-cash donations under this bill, a reasonable assumption must be made. Some taxpayers will re-direct donations and receive a tax benefit of 100 cents on the dollar as a credit against tax rather than a charitable deduction equal to 8 cents on the dollar. The charitable deduction benefit is based on a marginal tax rate of approximately 8% since it is applied against income before tax. . In addition, some taxpayers not currently making deductible donations would begin to do so because of the generous credit in this bill. A 20% assumption is reasonable and would strike a balance between a possibly higher or lower participation rate. If the credit rate were reduced, the assumption would be revised accordingly.

If corporate donations equaled 10% of PIT donations, the additional revenue loss attributed to corporations would be $22 million annually.

POLICY CONCERNS

Under existing law, a taxpayer contribution of property, including materials, equipment, or services may be limited to the cost paid or incurred by the taxpayer (their adjusted basis) for the property. A credit that is based on the fair market value of the property as opposed to the taxpayer's adjusted basis could potentially be construed as a disposition of the property triggering an amount realized and recognized that would in turn be subject to federal income tax if the taxpayer had a gain on the disposition.

This bill does not limit the amount of the credit that may be taken. Credits that could potentially be quite costly are sometimes limited either on a per-project or per-taxpayer basis, or alternatively on the basis of total credit for the entire year for all taxpayers.

Credits generally are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, which is unprecedented.

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