Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Nation | Analyst: John Pavalasky | Bill Number: AB 848

Related Bills: See Legislative History | Telephone: 845-4335 | Amended Date: May 12, 2003

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Depreciation Deduction/No Deduction Allowed For Large Sport Utility Vehicles (SUV)

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO _____.

____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.

X OTHER - See comments below.

SUMMARY

This bill would eliminate the California business incentives that currently exist for purchasing large sport utility vehicles (SUV).

SUMMARY OF AMENDMENTS

The May 12, 2003, amendments would:

- Modify the legislative findings to reflect the elimination of the California business incentives that currently exist for purchasing a large SUV.
- Strikeout the statutory provisions contained in the bill as introduced February 20, 2003.
- Add two new statutory provisions to California law, that deny depreciation deductions as well as small business expense deductions (including those pertaining to enterprise zones (EZ), local area military base recovery areas (LAMBRA), and targeted tax areas (TTA)) with respect to large SUVs, as defined.

PURPOSE OF THE BILL

According to the author's office the purpose of the bill is to modify California law to not allow the business tax benefit for purchasing a large SUV over a more fuel-efficient vehicle.

Board Position:			Department Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Gerald H. Goldberg	5/21/03
____ N	____ OUA	X PENDING		

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.

ANALYSIS

FEDERAL/STATE LAW

Current Federal Law

Under federal law 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 $25,000.

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 to 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 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. In addition, California allows a business operating in the following economic development areas, in lieu of the Section 179 deduction, to deduct currently as an expense (rather than depreciate) a larger portion of a depreciable asset (defined Section 1245(a)(3) of the Internal Revenue Code):

- Enterprise Zones (EZ's),
- Local Agency Military Base Recovery Areas (LAMBRA's), and
- Targeted Tax Area (TTA).

THIS BILL

Under California corporate and non-corporate tax law, with respect to large SUVs, as defined, this bill would deny depreciation deductions as well as small business expense deductions (including those pertaining to enterprise zones (EZ), local area military base recovery areas (LAMBRA), and targeted tax areas (TTA)) to the owners of these vehicles.

Thus, if a taxpayer purchases a large SUV, or the taxpayer leases the large SUV under a finance lease (i.e. the taxpayer and not the leasing company is treated as the owner of the vehicle), that taxpayer would be denied depreciation deductions as well as small business expense deductions with respect to that vehicle. However, if the taxpayer leases a large SUV under an operating lease (i.e. the leasing company is treated as the owner of the vehicle), the leasing company would be denied depreciation deductions as well as small business expense deductions with respect to any large SUVs that are leased to others. Under the bill the taxpayer with an operating lease would not be denied the business expense for the lease payments.

This bill would define a large SUV as a four-wheeled vehicle manufactured primarily for use on public streets, roads, and highways if the vehicle meets all of the following requirements:

(1) Is rated between 6,000 and 14,000 pounds gross vehicle weight,
(2) Is designed to seat nine or fewer individuals, and
(3) Is not equipped with an open cargo area with an interior length of 72 or more inches or does not have a covered box with an interior length of 72 or more inches that is separate from the passenger compartment.

LEGISLATIVE HISTORY

This is the first bill denying depreciation deductions as well as small business expense deductions with respect to large SUVs.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, Oregon,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws. Pending *Oregon* and *New York* legislation would deny depreciation deductions and small business expense deductions with respect to large SUVs. None of the other states surveyed are proposing similar legislation.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on the discussion below, the following table reflects the estimated impact of this bill:

Revenue Impact of AB848 As Amended 5/12/2003 For Taxable Years Beginning On Or After 1/1/2003 Assumed Enactment After 6/30/03 Fiscal Years (In Millions)		
2003-04	2004-05	2005-06
+ $40	+ $20	+ $5

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The impact of this bill would depend upon the number and costs of large SUVs, the amount of reduced depreciation and expense deductions that would have been allowable under current law, offset by the amount of tax decreases resulting from the resale of such vehicles at unreduced cost basis and the increase in deductible operating lease payments.

For purposes of this analysis, information obtained from a report released by US Public Interest Research Group in 1999 was used. In addition, the following assumptions were used: (1) assumed that 50% of large SUVs sold (or treated as sold under a finance lease) or leased under an operating lease currently are allowed some sort of deduction, (2) the average annual deduction is $5,000, (3) average write-off period of three years, (4) assume business use of SUVs will decline by 15% annually as a result of this bill, (5) average marginal tax rate of 6%, and (6) deductions would be disallowed for taxable years beginning on or after January 1, 2003, regardless of when the vehicle was placed in service.

To arrive at the annual revenue gain, it was determined from the US Public Interest Research Group's report that approximately 700,000 qualifying vehicles would be sold (or treated as sold under a finance lease) or leased under an operating lease in the United States in 2003. Of this total it is estimated that 11% would be located in California (77,000). Assuming 50% would no longer receive an average deduction of $5,000, disallowed deductions would amount to approximately $200 million for vehicles purchased (or treated as purchased under a finance lease) or leased under an operating lease in 2003.

It is estimated that total 2003 disallowed deductions would be approximately $570 million ($180 million for 2001, $190 million for 2002, and $200 million for 2003 purchased or leased vehicles). Assuming an average marginal tax rate of 6%, the first calendar year revenue gain is estimated to be $34 million (6% x $570 million = $34 million). That calendar year estimate was converted to the fiscal year estimates above and adjusted to reflect changes in estimated tax and final tax payments. The above revenue impact represents a timing affect, reduced depreciation deductions, and expenses offset in future years by a decrease in the amount of gain realized from the sale of the vehicle due to its basis unreduced by depreciation or expensing deductions.

ARGUMENTS/POLICY CONCERNS

Denying the deduction for depreciation and the expensing deduction with respect to large SUVs while allowing these deductions for other types of vehicles could be viewed as inequitable.

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