Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Torrico	Analyst:	Darrine Distefano	Bill Number:	AB 2128
Related Bills:	See Legislative History	Telephone:	845-4142	Introduced Date:	February 21, 2006
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Employer Provided Commuter Benefits Credit

SUMMARY

This bill would provide a tax credit for employers that provide commuter benefits to their employees.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to:

- Increase the number of employers providing commuter benefits for employees.
- Reduce the cost to the state and local governments for operating public transit.
- Assist low to moderate income California residents in reducing their gasoline tax.
- Increase federal funds for public transit.
- Apply market-based economics to alleviate California's dependence on imported oil.
- Reduce California's outgoing capital for imported oil and gasoline.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2007.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws allow taxpayers to deduct ordinary and necessary business expenses, which generally would include providing transit passes or other commuter benefits to employees.

Existing federal law allows employees certain exclusions from gross income for the value of employer-provided commuter transportation subsidies, including transit passes and qualified parking. Employees generally cannot deduct their regular costs of commuting to and from their place of business under either federal or state law.

Board Position:			Department Director	Date
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Current state law allows an employee to exclude from gross income the amount of compensation or the fair market value of any benefit (except salary or wages) received from an employer for participation in any ride-sharing program in California, including the value of a monthly transit pass for use by the employee or his or her dependents.

THIS BILL

Under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), this bill would provide a 56% (fifty-six percent) credit for costs incurred by a qualified taxpayer for providing commuter benefits to their employees.

This bill defines "commuter benefits" as the cost of a transit pass, commuter voucher, or similar item issued by a privately or publicly owned mass transit operator to a qualified taxpayer's employee that allows an employee to travel to and from work.

This bill also defines the following terms:

- "Commuter Route" is a route used by an employee to travel to their place of employment and back home.
- "Employer-sponsored commuter benefits credit program" is a program implemented by a qualified taxpayer to encourage, provide, or both, incentives, fiscal or other, to employees to use a qualified mass transit operator.
- "Qualified mass transit operator" is a motorized vehicle designed to carry, and capable of carrying, 15 or more passengers, or a rail line or fixed rail train designed to carry, and capable of carrying, four or more passengers that also satisfies the following requirements: manufactured on or after January 1, 2003 and has dual rear wheels; not funded by federal, state, or local government; participates in the employer-sponsored commuter benefits credit program; and not owned by the qualified taxpayer claiming the credit.
- "Qualified passenger" is an employee of a qualified taxpayer who has purchased a mass transit pass from a qualified mass transit operator.
- "Qualified taxpayer" is defined as the following:
    - An employer.
    - Implements an employer-sponsored commuter benefits credit program and documents that each employee receives a pass or voucher.
    - Pays the qualified mass transit operator directly in an electronic format.
    - Provides information to the qualified mass transit operator about the amount of tax credit claimed for costs incurred for the purchase of transit passes or vouchers.
    - Subsidizes the costs of transit passes or vouchers for their employees that use publicly funded mass transit.
        - The subsidy must be transmitted electronically to the qualified mass transit operator.
        - If the qualified mass transit operator cannot receive payments electronically, a qualified taxpayer would not be required to provide subsidies to employees who use publicly funded mass transit, but the qualified taxpayer would be able to claim the credit.
    - Has not claimed the federal deduction (business expenses) on an original or amended return for commuter subsidies provided to their employees in the last five taxable years.

This bill would restrict the credit if any amount of employer-sponsored commuter benefit is paid by an employee and later reimbursed by the qualified taxpayer. The credit is limited to the amounts set under federal law for qualified transportation.

This bill requires an employee of a qualified taxpayer to contribute at least 20% (twenty percent) toward the total purchase price of a mass transit pass. This amount must be paid electronically to the qualified mass transit operator.

This bill requires the owner of a qualified mass transit operator to remit at the end of each taxable year the lesser of either the amount equal to the amount of tax credit claimed by the qualified taxpayer or the amount equal to the applicable percentage of employer-sponsored commuter benefits paid by a qualified taxpayer to that operator. The applicable percentage means one of the following:

- 20% (twenty percent) of employer-sponsored commuter benefits paid by a qualified taxpayer to the operator when the operator transports 15 to 20 qualified passengers on the commuter route.
- 30% (thirty percent) of benefits paid when the operator transports 21 to 25 qualified passengers.
- 45% (forty-five percent) of benefits paid when the operator transports 26 to 30 qualified passengers.
- 65% (sixty-five percent) of benefits paid when the operator transports 31 to 39 qualified passengers.
- 75% (seventy-five percent) of benefits paid when the operator transports 40 to 49 qualified passengers.
- 85% (eighty-five percent) of benefits paid when the operator transports 50 or more qualified passengers.

The number of qualified passengers would be calculated based on the average of actual number of qualified passengers that paid for services from the operator over the reported period.

Under this bill, the state would not be required to reimburse a qualified mass transit operator for any amount remitted to the state and not claimed by the qualified taxpayer as a tax credit.

This bill would require the qualified taxpayer to do the following for auditing purposes:

- Retain each employee's personal information that received a mass transit pass or voucher, including his or her social security number, and residence address.
- Identify each qualified mass transit operator by their federal tax identification number that received funds under the credit.

This bill would allow an employee to contribute to a prepayroll tax deduction program.

This bill would not allow a carryover of any excess credit to succeeding taxable years, and the credit would not be refundable if it exceeds the amount of tax after all other credits have been applied.

This bill would allow a qualified taxpayer to claim the state deduction for ordinary and necessary business expenses.

This bill would prohibit a qualified mass transit operator, employee, or a qualified taxpayer from participating in the employer-sponsored commuter benefits credit program for at least two years from the date of a violation[1]. The operator, employee, or taxpayer may be required to reimburse the state for the amount of credit claimed plus an amount equal to 150 % (one hundred fifty percent) of the credit claimed.

This bill would preclude a qualified taxpayer from excluding a qualified mass transit operator chosen by a qualified passenger to participate in the employer-sponsored commuter benefits credit program. However, this provision would not apply under the following circumstances:

- The qualified mass transit operator has violated any provisions of this section.
- The qualified mass transit operator has imposed a fee on the qualified taxpayer greater than the cost of the transit pass.
- The qualified mass transit operator cannot provide evidence of meeting the qualifications required under this section.

IMPLEMENTATION CONSIDERATIONS

The language of this bill is complex, which may make it difficult for both taxpayer compliance and department administration. Department staff is available to assist with amendments to resolve both these complexities and the implementation concerns discussed in this analysis.

The following implementation concerns have been identified with this bill:

- The definition of "commuter benefits" is not clear. To alleviate confusion, the author may wish to combine the two terms "commuter benefits" and "employer-sponsored commuter benefits credit program" and require the pass to be issued to the employer who would in turn issue it to the employee. This would also assist the qualified taxpayer to maintain records for tracking transit passes or vouchers issued to an employee.
- This bill uses the term "employee" to identify a qualified taxpayer's employee who is issued a transit pass and then uses and defines the term "qualified passenger" to identify a qualified taxpayer's employee. To alleviate confusion, the author may wish to use one term throughout to identify who is eligible to receive a transit pass or voucher.
- This bill defines "qualified mass transit operator" as a motorized vehicle, a rail line, or fixed rail train designed to carry or capable of carrying a specific number of passengers. Since this term defines the type of transportation, not an individual, the author may wish to remove the term "operator" in order to avoid confusion between a person and a vehicle. The bill also uses the term "owner of a qualified mass transit operator," but that term is not defined. Lack of clearly defined terms may lead to disputes between the taxpayer and the department.
- The department lacks the expertise to verify the type of transportation utilized by an employee or the number of passengers a vehicle can safely carry. The author may consider requiring the proper local authority or a state agency to certify that the transportation used meets the requirements under this bill and is eligible for the credit. The author may also consider requiring the qualified taxpayer to obtain, retain, and provide evidence of this certification to the department upon request. The qualified taxpayer

[1] Bullet #12 under Implementation Considerations addresses an issue related to this provision.

should be required to obtain this certification as a pre-condition to claiming the credit under this bill. The author may wish to further clarify the type of transportation manufactured after January 1, 2003. It is not clear if the author intends to include transportation that is retrofitted after this date.

- Although the department receives federal tax information, exclusions from gross income taken on the federal return are combined and totaled. Therefore, it would be difficult for the department to determine whether the qualified taxpayer has claimed the deduction for commuter subsidies within the past five taxable years.
- This bill would require the owner of a qualified mass transit operator at the end of each taxable year to remit the lesser of the amount of credit claimed by the qualified taxpayer or a specified percentage according to the number of passengers. The language needs to be clear whether it is the taxable year of the owner of a qualified mass transit operator or the qualified taxpayer. Both individuals and businesses can file returns according to a calendar year or a fiscal year.
- Because this credit can be claimed beginning on or after January 1, 2007, it is assumed that an owner would need information on December 31, 2007. For a calendar year filer, tax returns for 2007 would not be filed until April or October of 2008. A qualified taxpayer would not be able to supply an owner with information about the amount of credit claimed until mid to late 2008.
- Without a clear definition of “taxable year,” an owner would be required to estimate the amount claimed because credit information would be unavailable. The owner could over or under estimate the amount that needs to be remitted to the state, and the state is not required to reimburse an owner for an overpayment. Therefore, this provision may dissuade an owner from participating in the program since the amounts paid cannot be verified.
- The bill fails to identify who the “state” is for an owner to remit payments. There would also need to be a system or some type of process in place to verify amounts claimed with amounts remitted to the state.
- The calculation of the time base, 30 percent of the time calculated on a 12 month basis, to determine if the program is being utilized according to the credit requirements needs to be clarified.
- This bill would allow the credit to a qualified taxpayer who denies subsidies for an employee who uses transportation from an operator who is prevented from accepting electronic payments. This would provide a benefit to a qualified taxpayer for an expense that was not incurred.
- This bill prevents an operator, employee, or qualified taxpayer from participating in the employer-sponsored commuter benefits credit program if any provisions of this credit are violated. The bill needs to identify who will verify the violations and who needs to be notified of the violations as well.
- The bill needs to identify what type of fee would be imposed on the qualified taxpayer by the operator.

TECHNICAL CONSIDERATIONS

On page 5, line 37, and page 10, line 7, the word “cost” has been misspelled.

On page 5, line 20, and on page 9, line 30, Section 17144.5 is identified as providing a deduction for ridesharing expenses. This section does not exist in either the PITL or the CTL, and it is not clear which deduction the language intends to limit. There is an exclusion from gross income under the PITL, Section 17149, for compensation received by an employee for ride sharing benefits, and a deduction under CTL Section 24343.5. The author needs to clarify which section the bill intends to limit a deduction for.

LEGISLATIVE HISTORY

AB 547 (Figueroa, 2001/02) would allow employers a credit of varying percentages from 20% to 80% for providing subsidized public transit passes to their employees. This bill was held in the Assembly Revenue & Taxation Committee.

SB 1427 (Rainey, 1999/2000) also would have allowed a tax credit for an employer who subsidized public transit passes. This bill failed to pass out of the Senate Revenue and Taxation Committee.

AB 171 (Cunneen, 1997/1998) would have allowed a tax credit for an employer who subsidized its employees’ public transit passes or subsidized monthly vanpool fare. This bill failed to pass out of the Assembly Appropriations Committee.

AB 1702 (Figureoa, 1997/1998) would have allowed a tax credit for an employer who subsidized public transit passes. This bill failed to pass out of the Assembly Appropriations Committee.

PROGRAM BACKGROUND

For taxable or income years beginning on or after January 1, 1989, and before January 1, 1996, state law allowed employers a ride-sharing tax credit with two components. Employers were allowed a tax credit equal to 10% to 40% of the cost of providing subsidized public transit passes to employees, depending upon whether the employer offered free or subsidized parking. The second component was a tax credit for the purchase or lease of specified shuttle or commuter vehicles as part of an employer-sponsored ride-sharing incentive program. The credit was 20% for an employer with 200 or more employees and 30% for an employer with fewer than 200 employees.

Prior state law also provided a transit-related tax credit to employees equal to 40% of the subscription costs paid or incurred for participation in a non-employer-sponsored vanpool program.

OTHER STATES’ INFORMATION

Illinois allows taxpayers to deduct, if included in adjusted gross income, ride-sharing or other benefits received by a driver in a ridesharing arrangement.

Minnesota provides corporations a 30% credit equal to the difference between the price the corporation paid for transit passes and the price charged employees for the passes. It is non-refundable and can only be applied to the corporation's current tax liability.

Review of *New York, Michigan*, and *Massachusetts* laws found no comparable tax credits or deductions.

These states were reviewed because of the similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved. Most new credits require system changes and a worksheet to be placed in the tax booklet to help taxpayers calculate the credit. Changes of that nature can be made during the department's annual update with minor impacts to the department.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

This bill would produce annual revenue losses as follows:

Estimated Impact of AB 2128 on California Applicable for taxable years beginning on or after 1/1/07 *(Rounded to Nearest $500K)*			
Fiscal Year	2006-07	2007-08	2008-09
Employer-Sponsored Commuter Benefits Program Tax Credit	none	/a	/a

a/ Insignificant loss of less than $150,000

<u>Revenue Discussion</u>

This bill would primarily benefit employers that implement <u>new</u> commuter benefit programs with third-party vanpool transportation services. The cost of the proposed credit would depend on the amount of induced growth in large vanpool mass transit services over current levels, as explained below.

According to national forecast models, vanpools comprise only 0.2% of all commuter transportation. Based on California's labor force of around 17 million, this suggests the total market for vanpools is about 34,000. Based on American Vanpool Transportation Agency (APTA) statistics, commuter vans servicing 15 or more passengers represent about 15% of the total vanpool vehicle market. Hence, the total existing market for the largest vanpools targeted by this credit is an estimated 5,100 (34,000 X 15%) passengers. Since this bill restricts the credit to employers that are not already deducting commuter subsidies for its employees, the initial rate of adoption of new ESCB programs would be relatively small. The estimate assumes 5% growth in the number of qualified passengers in 2007 (5% of 5,100 = 255), and another 5% in 2008 (255 x 2 = 510).

Under federal law, the amount of commuter benefits per eligible employee cannot exceed $1,260 annually. According to one of the leading vanpool providers in the nation, the average cost of monthly vanpool fares in major metropolitan areas is $120. To qualify for the proposed credit, the employee would need to contribute at least 20% of this cost, or $25 per month. Assuming the employer would split the costs 70/30, the employer would pay $84 per month and would receive a $47 tax credit (56% of $84). Based on a full twelve months, the allowable credit would equal about $560 per employee ($47 x 12). If 255 employees qualify their employer for a $560 credit, the revenue impact would be about $143,000 for the initial year of enactment. By the second year, allowable credits are estimated to double to $286,000. The amount of applied credits is assumed to be 80% of allowed, equal to about $115,000 and $229,000 for each of the first two impact years.

In addition, the bill requires the mass transit operator to remit a percentage of the fares it receives directly from the qualified employer or the actual amount of credits claimed, whichever is less. It is assumed that 30% of the qualified fares would be recovered from mass transit operators via the remittance clause. As noted above, an employer's share of benefits paid is estimated to be $84, or about $1,000 annually. At 30%, this equates to $300 per employee, or $76,500 ($300 x 255) and $153,000 ($300 x 510) over the first two years, respectively. This offset reduces the estimated impact to $38,500 ($115,000 – $76,500) for 2007-08 and $76,000 ($229,000 – $153,000) for 2008-09, as reflected in the above table.

ARGUMENTS/POLICY CONCERNS

This credit lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a credit or subsidy by the Legislature.

This bill would allow a credit for an item that is already deductible as a business expense. By allowing both a credit and a deduction, a double benefit is provided for the same expenditure. Attached are amendments that would resolve this issue.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2128
As Introduced February 21, 2006

AMENDMENT 1

On page 6, after line 3, insert:

(k) Any deduction otherwise allowed under this part for any amount paid or incurred by the taxpayer upon which the credit is based shall be reduced by the amount of the credit allowed under this section.

AMENDMENT 2

On page 10, after line 11, insert:

(k) Any deduction otherwise allowed under this part for any amount paid or incurred by the taxpayer upon which the credit is based shall be reduced by the amount of the credit allowed under this section.