

**SUMMARY ANALYSIS OF AMENDED BILL**

Author: Torrico Analyst: Darrine Distefano Bill Number: AB 2128  
 Related Bills: See Prior Analysis Telephone: 845-4142 Amended Date: April 17, 2006  
 Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Employer Provided Commuter Benefits Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced February 21, 2006.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED \_\_\_\_\_ STILL APPLIES.

OTHER – See comments below.

**SUMMARY**

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

**SUMMARY OF AMENDMENTS**

The April 17, 2006, amendments delete the original provisions of the bill as introduced February 21, 2006, and added revised language that is discussed under "This Bill."

The amendments resolve the technical considerations and the policy concerns from the bill as introduced on February 21, 2006. The remaining unresolved implementation concerns are repeated below for convenience. In addition, new implementation and technical concerns are included. A new federal/state law discussion and revenue estimate is also provided. The remainder of the analysis of the bill as introduced on February 21, 2006, still applies.

**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 and before January 1, 2017.

Board Position:	Legislative Director	Date
<input type="checkbox"/> S <input type="checkbox"/> NA <input type="checkbox"/> NP <input type="checkbox"/> SA <input type="checkbox"/> O <input type="checkbox"/> NAR <input type="checkbox"/> N <input type="checkbox"/> OUA <input checked="" type="checkbox"/> PENDING	Brian Putler	04/28/06

## **POSITION**

Pending.

## **ANALYSIS**

### FEDERAL/STATE LAW

Existing federal and state law allows taxpayers to deduct ordinary and necessary expenses paid or incurred in a trade or business or in the production of income, including compensation paid to employees.

Individuals are subject to tax on gross income, including compensation received for service as an employee, unless specifically excluded by law. Existing federal and state law allows employees to exclude from income qualified transportation fringe benefits. These benefits include the following:

- Transportation in a commuter highway vehicle (vanpool) in connection with travel between the employee's residence and place of employment.
- Transit passes for use on a mass transit facility (rail, bus, or ferry) or a commuter highway vehicle.
- Qualified parking at or near the employer's business premises or location from which the employee commutes to work by mass transit or hired commuter vehicle. Parking at or near the employee's residence is not qualified parking.

For 2006, the following amounts can be excluded: (1) up to \$205 a month for qualified parking and (2) up to \$105 a month of the combined value of transit passes and vanpools. Cash reimbursements, but not cash advances, are excludable. Reimbursements for transit passes are excludable only where vouchers aren't immediately available for direct distribution by the employer to the employee.

Employers are also subject to certain federal and state taxes on wages paid to employees. These federal employment taxes include the employer portion of the Federal Contribution Act (FICA) taxes at a 7.65% rate. The FICA tax is composed of two component parts, the old age and survivor insurance component at a rate of 6.2% and the Medicare component at a 1.45% rate. Employees are also subject to these taxes on wages at the same rates. In general, for purposes of these federal taxes, wages consists of compensation paid for services of an employee with certain specified exclusions such as qualified transportation fringe benefits that are excluded from the gross income on an employee.

### THIS BILL

Under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), this bill would provide a 60 percent credit for costs incurred by qualified taxpayers 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 qualified mass transit to a qualified taxpayer that allows a qualified passenger that works for a qualified taxpayer to travel to and from work.

This bill also defines the following terms:

- “Commuter Route” is a path used at a specific time by a qualified passenger to travel to their place of employment and back home.
- “Commuter” is an individual driving, riding, or performing other physical means of transportation to travel to their place of employment and back home.
- “Qualified mass transit” is a motorized vehicle designed to carry, and capable of carrying, 16 or more passengers.
- “Owner of qualified mass transit” is an individual, organization, or company that operates or manages a motorized vehicle designed to carry 16 or more passengers for a specific commuter route and satisfies all of the following:
  - Provides proof to the qualified taxpayer that the motorized vehicle is capable of carrying 16 or more passengers.
  - Does not receive funds from state or local government.
  - Participates in the commuter benefits credit program.
  - Is not the qualified taxpayer claiming the credit.
  - Does not operate a commuter route on an existing publicly funded mass transit commuter route.
- “Qualified passenger” is an employee of a qualified taxpayer who receives a commuter benefit from a qualified taxpayer and uses the services of an owner of a qualified mass transit for commuting.
- “Qualified taxpayer” is a taxpayer that satisfies the following conditions:
  - An employer.
  - Provides commuter benefits for qualified passengers.
  - Pays the owner of qualified mass transit, or his or her agent, for the cost of the transit pass, commuter voucher, or similar item.
  - Distributes payment by the qualified passenger for the transit pass in combination with the commuter benefits issued by the qualified taxpayer.
  - Makes payment to the owner in an electronic format.
  - Subsidizes the costs of publicly funded mass transit passes for their employees that use publicly funded mass transit.
  - The subsidy must be transmitted electronically to the owner of a qualified mass transit.
  - If the owner of a qualified mass transit 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.
- “Existing publicly funded mass transit commuter route” is a mass transit system that meets all of the following:

- o Has operated since January 1, 2007.
- o Has a start destination within two miles of the qualified passenger’s residence and a final destination within a quarter-mile of the qualified passenger’s worksite.
- o Has a schedule within an hour time period of the commuter route offered by the owner of a qualified mass transit.

This bill would restrict the credit if any amount of the commuter benefit is paid by a qualified passenger and later reimbursed by the qualified taxpayer. The credit is limited to the amounts set under federal law for qualified transportation and excludes the required qualified passenger contribution.

This bill would require a qualified passenger of a qualified taxpayer to contribute at least 20 percent toward the total purchase price of a mass transit pass. This amount must be paid electronically to the owner of a qualified mass transit or his or her authorized agent.

This bill would require the owner of a qualified mass transit, or his or her authorized agent, to remit annually, on or before April 15<sup>th</sup> of each calendar year to the Franchise Tax Board (FTB) 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 commuter benefits paid by all participating qualified taxpayers to the owner of a qualified mass transit.

This bill defines “applicable percentage” as the total number of qualified passengers per commuter route using the service provided during the specified calendar month, according to the following table:

<b># of Qualified Passengers</b>	<b>Applicable Percentage</b>
16	2.0
17	4.6
18	9.5
19	14.0
20	18.0
21	21.5
22	25.0
23	28.0
<b># of Qualified Passengers</b>	<b>Applicable Percentage</b>
24	31.0
25	34.0
26	37.0
27	40.0
28	42.0
29	44.0
30	49.0
31	54.0
32	55.0

33	56.0
34	57.0
35	58.0
36	59.0
37	60.0
38	61.0
39	63.0
40	64.0
41	65.0
42	66.0
43	67.0
44	68.0
45	69.0
46	70.0
47	71.0
48	72.0
49 or more	75.0

The number of qualified passengers would be calculated based on the average of the actual number of qualified passengers that paid for services from the owner over a reported calendar month.

Under this bill, the state would not be required to reimburse an owner of a qualified mass transit, or his or her agent, for any amount remitted to the state and not claimed by the qualified taxpayer as a tax credit.

This bill would require the owner of a qualified mass transit, if requested by FTB, to report within 60 days the number of qualified passengers that paid for its services for each commuter route in each calendar month over the last 12 months or any time period requested. The report would include all of the following:

- The names of the qualified taxpayer making payments on behalf of qualified passengers.
- The federal identification numbers of the qualified taxpayers.
- The amount paid by each qualified passenger.
- The total number of qualified passengers subsidized by each qualified taxpayer.
- The total number of qualified passengers on each commuter route.

If required to provide the report to FTB, the owner would be required to notify the qualified taxpayer at least 30 days prior to submitting the report. The owner would be required to provide the same information to the qualified taxpayer upon request.

If an owner does not meet the minimum requirements for operating a motorized vehicle capable of carrying 16 or more passengers, the owner must notify the qualified taxpayer in writing within 20 days that the qualified taxpayer is ineligible to receive a credit under this section.

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 owner of a qualified mass transit by their federal tax identification number that received funds under the credit.
- Verify that each qualified mass transit operates a qualified motorized vehicle according to the rules adopted by FTB.

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

This bill would not allow a carryover of any excess credit to succeeding taxable years.

This bill would allow a qualified taxpayer to claim the state deduction for ordinary and necessary business expenses. In addition, this bill also requires a taxpayer to reduce the amount of the deduction by the amount of the credit taken.

This bill would prohibit an owner of a qualified mass transit from participating in the commuter benefits credit program for at least two years from the date of a violation.<sup>1</sup> The owner is 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. Violations would be reported to FTB who would in turn request documentation from the qualified mass transit for proof of compliance.

This bill would prohibit a qualified taxpayer from excluding an owner of a qualified mass transit chosen by a qualified passenger to participate in the commuter benefits credit program. This provision would not apply under the following circumstances:

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

This bill would prohibit a taxpayer from claiming the federal deduction for ordinary and necessary business expenses, which generally would include transit passes or other commuter benefits to employees.

This bill would be repealed on December 1, 2017.

## IMPLEMENTATION CONSIDERATIONS

The language of the bill contains several inconsistencies and employs a method for qualifying and calculating the credit, which may make it difficult for both taxpayer compliance and department administration. Department staff is available to provide further assistance to the author to resolve the concerns noted in this analysis.

---

<sup>1</sup> According to Black's Law Dictionary, the word "violation" means injury; infringement; breach of right, duty, or law; ravishment; seduction.

The bill defines the term "owner of qualified mass transit" as an individual or entity that operates or manages a motorized vehicle; however, the language would allow the "owner" to avoid ownership interest in the vehicle. The qualified taxpayer could own the vehicle and claim the credit because he or she does not operate or manage the vehicle. Similarly, the bill defines "existing publicly funded mass transit commuter route" in terms of the route, but lacks a requirement for a route to be related to a publicly funded mass transit system.

The bill imposes violations on the owner of a qualified mass transit. The term "violation" is generally limited to criminal provisions. A failure to comply with requirements of a tax credit is usually stated as such. In addition, sanctions for failure to comply with tax credit provisions are generally imposed on the taxpayer claiming the credit and are reserved for failure to comply with essential aspects of a credit. The violations in this bill are imposed on a third party.

The bill limits the amount a qualified taxpayer may pay for the commuter benefits. Normally, tax credit language is written to limit the credit to a percentage of the amount paid. Limiting the amount that may be paid creates significant compliance issues. The department would need to determine that amounts paid did not exceed a certain amount. The department does not routinely examine amounts in excess of the amount that would provide the basis for a credit. In order for the department to determine if the credit was claimed correctly, the taxpayer would need to provide information on the total number of employees that received a qualified transportation benefit under Section 132(f) of the Internal Revenue Code (IRC) and the total amount paid. This verification process could delay the FTB's return processing procedures.

The following additional implementation concerns have been identified with this bill:

- The bill lacks definitions for the term "commuter benefits credit program" and "publicly funded mass transit system". In addition, throughout the bill, the term "qualified" is used as part of a defined term. In other places, it uses the term "qualified" as an adjective because the term is not defined.
- The bill includes language to prohibit a qualified taxpayer from claiming the deduction for ordinary and necessary expenses (IRC Section 162(a)). It is unclear what this provision intends to prevent. Taxpayers are allowed to deduct compensation paid to employees as a necessary and ordinary expense, including compensation paid to an employee in the form of a nontaxable fringe benefit, such as a qualified transportation fringe under IRC Sec. 132(f). As drafted, this provision does not limit the taxpayer from continuing to take the deduction.
- The bill is silent about how the owner would remit amounts to FTB. At the minimum, a separate form and processing system would need to be created to allow FTB to capture owner information and process amounts received from the owner. FTB would have no other use for the database and processes beyond collecting this information. Maintenance and updates to a database that is used only for this purpose could redirect department resources away from other revenue generating projects and annual updates.
- An owner must remit amounts annually on or before April 15<sup>th</sup>. FTB's peak season is between January and May. The department must process income tax returns, refunds, and payments within this time frame. Requiring additional payments to be processed

during this peak season could also redirect department resources away from this priority workload.

- This bill fails to identify at what point before the 20 day written notification that an owner must notify the qualified taxpayer that he or she is ineligible for the credit.
- This bill requires FTB to do the following: (1) create rules to verify that the owner operates a qualified motorized vehicle and (2) verify any violations of an owner of the qualified mass transit. FTB administers the PITL and CTL and lacks expertise in the automotive field. The department would defer that authority to a local authority or state agency to certify that the transportation used meets the requirements under this bill. The owner of the qualified mass transit should keep a copy of the certification should the qualified taxpayer request this information for audit purposes. A similar concern was originally brought up in the department’s analysis of the bill as introduced.
- This bill would allow the credit to a qualified taxpayer that denies commuter benefits for a qualified passenger because an owner is prevented from accepting electronic payments. This would provide a benefit to a qualified taxpayer for an expense that was not incurred. This concern was originally brought up in the department’s analysis of the bill as introduced.

**TECHNICAL CONSIDERATIONS**

On page 6, line 21 and on page 12, line 30, it appears that the language should reference paragraph (5), instead of paragraph (4).

On page 6, lines 7 and 8, and page 12, lines 15 and 16 need to be deleted. These requirements are repeated directly above under above subparagraph (C).

**FISCAL IMPACT**

As stated under “Implementation Considerations,” if the department is required to create separate forms and a database to track owner information and payments, the department would incur additional costs for printing, processing, and system changes. Department costs may also be incurred if resources are redirected from critical workloads during peak season and the department’s annual update. The additional costs have not been determined at this time. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested.

**ECONOMIC IMPACT**

Revenue Estimate

This bill would produce annual revenue losses as follows:

Estimated Impact of AB 2128 on California as amended April 17, 2006 Applicable for tax 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

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

#### Revenue Discussion

The original revenue impact for this bill estimated the yearly value of allowable credits at about \$560 per employee. Due to changes in the credit percentage, the revised credit value is estimated as \$600 per year for each employee. The amendment does not appear to alter the size of the qualified population. For the 2007 year, the projected number of qualified employees was 255. This amount is projected to double to 510 in the second year of enactment. Allowable credits are estimated at \$153,000 in 2007 and \$306,000 in 2008. Of this amount, only 80% would be applied against tax, roughly \$122,000 and \$244,000 respectively.

#### *Revenue Offset from Remittances*

The original analysis assumed an “applicable percentage” of 30 percent based on an estimated number of 21-25 qualified passengers per commuter route per month. The remittance amount is based on an estimated average annual qualified fare of \$1,000. Using the original 30% figure yields a remittance of \$300 per qualified passenger. As revised, the applicable percentage for this size commuter group is 28%. This yields a \$280 remittance per qualified passenger. Projected repayments would be \$71,400 (\$280 x 255) and \$142,800 (\$280 x 510) over the first two years, respectively. This offset reduces the revised estimated impact to \$50,600 and \$101,200, as reflected in the above table.

#### **LEGISLATIVE STAFF CONTACT**

Darrine Distefano  
Franchise Tax Board  
(916) 845-4142  
[darrine.distefano@ftb.ca.gov](mailto:darrine.distefano@ftb.ca.gov)

Brian Putler  
Franchise Tax Board  
(916) 845-6333  
[brian.putler@ftb.ca.gov](mailto:brian.putler@ftb.ca.gov)