

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Nakanishi Analyst: Gail Hall Bill Number: AB 2616

Related Bills: See Legislative History Telephone: 845-6111 Introduced Date: February 24, 2006

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Qualified Vehicle Transaction Deduction

SUMMARY

This bill would provide to personal income taxpayers a \$3,000 deduction for purchasing or leasing a hybrid vehicle.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide taxpayers with an additional incentive to purchase fuel-efficient, environmentally-friendly vehicles.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon signature and apply to taxable years beginning on or after January 1, 2006, and ending on or before January 1 of a qualified year (as defined).

POSITION

Pending.

ANALYSIS

Federal Law

The Energy Policy Act of 2005 (EPACT) created a tax credit for individuals and businesses that buy or lease, after January 1, 2006, a new hybrid gas-electric car or truck¹. The credit ranges from \$250 - \$3,400 depending on the fuel economy and the weight of the vehicle. The credit will be phased out for each manufacturer once that company has sold 60,000 eligible vehicles. At that point, the tax credit for each company's vehicles will be gradually reduced over the course of

¹ Internal Revenue Code (IRC) Section 30B (d).

Board Position:	Department Director	Date
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another year. The following requirements must be met to claim the credit:

- The original use of the vehicle commences with the taxpayer,
- The vehicle is acquired for use or lease by the taxpayer, and not for resale,
- The vehicle is used mostly in the United States, and
- The vehicle must be placed in service by the taxpayer after December 31, 2005, and must be purchased on or before December 31, 2010.

In addition, federal law provides a tax credit for the purchase of a qualified electric vehicle. The maximum credit is \$4,000 and is gradually phased out beginning in tax year 2004. Qualified electric vehicles placed in service after December 31, 2006, do not qualify for the credit.²

State Law

Current state law lacks a deduction or tax credit for hybrid vehicles.

THIS BILL

For each taxable year beginning on or after January 1, 2006, and before January 1 of a qualified year, this bill would provide personal income taxpayers with a \$3,000 deduction for each qualified vehicle transaction during the taxable year.

“Qualified vehicle transaction” means purchasing or beginning an initial lease of a qualified vehicle in the state during the taxable year.

“Qualified vehicle” means a 2006 or newer model year qualified hybrid motor vehicle that meets the requirements of the federal income tax credit for hybrid vehicles.

“Qualified year” means the earlier of January 1, 2010, or the year that immediately follows the first year in which at least 100,000 qualified vehicles are sold and registered in the state.

IMPLEMENTATION CONSIDERATIONS

1. On page 2, line 9, the language “which requirements are specified in the regulations described in Section 30B(l)(2) of the Internal Revenue Code” may be confusing to taxpayers and the department. See attached Amendment 1 for recommended language.
2. The deduction is available for taxable years beginning on or after January 1, 2006, and before January 1, 2010. As soon as the state sells and registers 100,000 qualified vehicles, the deduction would not be available for the following taxable year. The department would need to be notified of the specific date the state reaches the 100,000 qualified vehicles to properly administer the deduction. In addition, a taxpayer would need notification if the new hybrid vehicle qualifies for the deduction.

² IRC Section 30.

LEGISLATIVE HISTORY

AB 838 (Saldana, 2005/2006) would have allowed individuals and businesses that purchase “qualified vehicles” a tax credit equal to the amount of the vehicle license fee paid annually to register one of these vehicles. AB 838 was held in the Assembly Appropriations Committee.

AB 1390 (Ridley-Thomas, 2003/2004) would have allowed a tax credit for the purchase of a new fuel-efficient vehicle if the Department of Finance certified that it found projected state revenues exceeded projected state expenditures. This bill remained in the house of origin.

AB 2484 (Ridley-Thomas, 2003/2004), AB 198 (Nation, 2003/2004), and AB 848 (Nation, 2003/2004) would have denied the general California business incentives relating to vehicles when a business purchased a large sport utility vehicle (SUV). The revenue from disallowing these incentives would have been used to fund a credit for the purchase and use of qualified reduced-emission vehicles in this state. AB 2484 was held in Assembly Appropriations, AB 848 remained in the house of origin, and AB 198 was held in Senate Appropriations.

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. Research found that these states do not offer a hybrid vehicle deduction or tax credit under current law.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this proposal would result in the following revenue losses.

Estimated Revenue Impact of AB 2616 Effective for Tax Years BOA 1/1/2006 Assumed Enactment Date After 6/30/06		
(in Millions)		
2006/07	2007/08	2008/09
-\$15	-\$20	No impact

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 revenue impact of AB 2616 depends on the number of hybrid vehicles, 2006 models and newer, sold and registered in California. This deduction would sunset on January 1 of the year after, the year in which at least 100,000 hybrid vehicles are purchased and registered in California.

California represents 25% of the U.S. hybrid car market. Based on market trend projections and the number of hybrid cars currently registered in California, it is estimated that qualified hybrid purchases would total 64,000 for calendar year 2006, 90,000 vehicles for calendar 2007 and 125,000 for 2008.

For calendar year 2006, total tax deductions would equal \$192 million (64,000 vehicles x \$3,000). Assuming an average marginal tax rate of 7.0 percent, the revenue loss for fiscal year 2006/2007 is estimated to be approximately \$13 million (\$192 million x 7.0%). The revenue loss of \$13 million is increased by \$2 million to account for a small portion of taxpayers that would alter their withholding during the first half of the 2007 calendar year resulting in a total estimate revenue loss of \$15 million for fiscal year 2006/2007.

It is anticipated that the threshold of 100,000 vehicles will be reached during the 2007 calendar year, and some taxpayers planning to purchase a hybrid in 2008 would make their purchase in 2007 to take advantage of the tax benefit. Therefore, 15 percent of projected 2008 hybrid purchases would shift by one year and bring total qualified purchases made during 2007 to approximately 108,000 vehicles [90,000 + (15% x 125,000)]. For fiscal year 2007/2008 deductions would total approximately \$325 million (108,000 x \$3,000), and the revenue loss would be approximately \$20 million (\$325 mil x 7.0% less \$2 million applied to fiscal year 2006/2007).

It is estimated there would be no impact to revenue for fiscal year 2008/2009 because the threshold of vehicles would reach 100,000 in 2007, resulting in the sunset of the hybrid car deduction on January 1, 2008.

LEGAL IMPACT

If this bill requires taxpayers to purchase qualified vehicles in the state to qualify for the deduction, the deduction may be subject to constitutional challenge. The U.S. Court of Appeals for the 6th Circuit rules in *Cuno v. DaimlerChrysler, Inc.* (2004) 386 F. 3d 738 that Ohio's Investment Tax Credit is unconstitutional because it gives improper preferential treatment to companies to locate or expand in Ohio rather than in other states and, therefore, violates the Commerce Clause of the U.S. Constitution. The U.S. Supreme Court is currently reviewing this case. The Court will issue its decision on this case by the end of June, 2006. Although the outcome of this decision and its affects on the income tax incentives of other states, including California, is unknown, targeted tax incentives that are conditioned on activities in California may be subject to constitutional challenge.

ARGUMENTS/POLICY CONCERNS

1. This bill would allow taxpayers in certain circumstances to claim multiple tax benefits, the \$3,000 hybrid vehicle deduction and a depreciation deduction, for the same item of expense. The author may want to require that the depreciable basis of the qualified vehicle be reduced by the \$3,000 hybrid vehicle deduction. (See attached Amendment 2)
2. This bill would establish a deduction for which federal law has no counterpart, thus increasing nonconformity and increasing the complexity of California tax return preparation.
3. A hybrid vehicle may qualify for the federal tax credit, but not qualify for the state's \$3,000 qualified vehicle deduction. This is because state and federal law have differing rules when sales of hybrid cars reach a certain amount. This may cause confusion for taxpayers.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2616
As Introduced February 24, 2006

AMENDMENT 1

On page 2, strikeout lines 9 and 10, and insert:

and any regulations prescribed under Section 30B(i)(2) of the Internal Revenue Code.

AMENDMENT 2

On page 2, after line 16, insert:

(d) The basis of any qualified vehicle shall be reduced by the portion of the deduction taken into account under subdivision (a).