Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Ducheny	Analyst:	Raul Guzman	Bill Number:	SB 491
Related Bills:	See Legislative History	Telephone:	845-4624	Amended Date:	04/28/05
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT:	Depreciation Deduction/Seismic Safety Requirements on Investor Owned Hospitals

SUMMARY

This bill would allow a special depreciation deduction for certain hospitals that incur costs to comply with seismic safety requirements.

This analysis will only discuss the bill as it impacts the Franchise Tax Board (FTB).

SUMMARY OF AMENDMENTS

The April 28, 2005, amendments made changes to the Health and Safety Code and to the Corporation Tax Law with respect to certain hospitals and depreciation deductions allowed for installing seismic safety standards.

As introduced February 18, 2005, this bill made changes to the Health and Safety Code regarding hospital facilities and seismic safety.

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

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to ensure that hospital services will remain available to California residents while also ensuring that hospitals comply with seismic safety design and construction standards.

EFFECTIVE/OPERATIVE DATE

This bill is an urgency statute and would be effective immediately. The special depreciation deduction would be expressly operative with respect to costs paid or incurred on or after January 1, 2008.

POSITION

Pending

Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the implementation, technical, and policy concerns discussed in this analysis.

Board Position:			Department Director	Date
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ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of property used in the production of income or property used in a trade or business. The amount of this deduction is determined, in part, by the cost, or basis, of the property. In addition, the property must have a limited, useful life of more than one year. Depreciable property includes equipment, machinery, vehicles, and buildings, but excludes land.

The California Corporation Tax Law generally uses federal methods that predate the federal modified accelerated cost recovery system (MACRS) and the alternative depreciation system (ADS) on commercial and industrial real property. Instead, property must be depreciated over its estimated useful life, which is the period over which the asset may reasonably be expected to be useful in the trade or business. Taxpayers may elect to use the useful life specified under the federal Class Life Asset Depreciation Range System (ADR). ADR grouped assets into more than 100 classes and assigned an asset guideline period, or useful life, to each class.

The Corporation Tax Law does not require that an election be made to adopt the ordinary straight-line method, declining balance method, or the sum-of-the-years-digits method. The straight-line method and the sum-of-the-years-digits method require a salvage value; the declining balance method does not require a salvage value. California has conformed to the federal 39-year recovery period for nonresidential real property placed in service on or after January 1, 1996. Most nonresidential real property, however, is depreciated over at least 30 years up to the maximum of 39 years.

Generally, significant improvements to real property are added to the basis, or cost, of the property and are depreciated over the property's remaining useful life.

THIS BILL

This bill would allow corporate taxpayers a special depreciation deduction for costs paid or incurred to complete necessary seismic safety capital improvements. The deduction would be equal to twice the annual rate of depreciation allowed under current law for a maximum period of ten years.

This bill would only apply to taxpayers that completed necessary seismic safety capital improvements to private, investor-owned hospitals that qualify as disproportionate share hospitals under Section 14105.98 of the Welfare and Institutions Code.

This bill would allow this special depreciation deduction only for costs paid or incurred on or after January 1, 2008.

IMPLEMENTATION CONSIDERATIONS

The following implementation considerations would need to be resolved before the department could implement this bill:

The bill would provide that any capital improvements associated with seismic safety could be depreciated at twice the annual rate for ten years. The bill is silent, however, what year capital improvements associated with seismic safety can be performed and still be eligible for the special depreciation. The bill does not provide a time limit for when the safety improvements must be made. Most bills are enacted with a limited life for the tax benefit they are providing.

For clarity and to avoid confusion for taxpayers and the department, the author should consider explaining that the ten-year period requirement does not change or reduce the life of the asset that is being depreciated. For example, if a seismic improvement were done to real estate with a 30-year life, the taxpayer would get the benefit of the special depreciation deduction for ten of the 30 years. The taxpayer would deduct the regular depreciation amount for the remaining 20 years.

This bill would only apply to improvements related to seismic safety as required under the Health and Safety Code. FTB staff lacks expertise in seismic safety requirements of hospitals. Accordingly, it is unclear how FTB would verify whether the cost of a taxpayer's improvements to a hospital would qualify as seismic safety improvements. The author may want to consider having a qualified third party certify that the improvements meet the seismic safety standards of the Health and Safety Code.

TECHNICAL CONSIDERATIONS

This bill is adding Section 24349.1 to the Revenue and Taxation Code; however, Section 24349.1 already exists under current law. A different section number should be used to prevent confusion.

This bill provides that depreciation “shall be allowed at twice the annual rate specified by Section 24349….” Section 24349 provides the method for computing the annual allowed or allowable amount of depreciation; it does not quantify depreciation by rate.

LEGISLATIVE HISTORY

SB 677 (McPherson, 2001/2002) would have allowed taxpayers a credit equal to an unspecified percentage of the certified final cost of seismic retrofitting paid or incurred during a taxable year to comply with the CBSC seismic retrofit building standards for hospitals, as enacted in SB 1953 (Alquist, Stats. 1994, Ch. 740.) SB 677 failed passage out of the Assembly Revenue and Taxation Committee.

SB 875 (Marks, 1995/96) would have allowed a credit for an amount equal to 10% of the costs for rehabilitating a residential historic building and 20% for a commercial historic building. This bill failed passage out of the Assembly Revenue and Taxation Committee.

OTHER STATES’ INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan*, *Minnesota*, and *New York* laws found no comparable tax provisions as proposed in this bill. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not impact the department’s costs if a third party performs the seismic safety standards improvements certification as required by the Health and Safety Code.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the Corporation Tax revenue loss from this bill would be as follows:

Estimated Revenue Impact of SB 491 as Amended 4/28/05 Effective On Or After January 1, 2008 Enactment Assumed After June 30,2005 ($ Thousands)		
2008-09	2009-10	2010-11
a/	a/	a/

a/ Loss less than $500,000.

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

Revenue Discussion

Governmental data show about 60 privately owned Disproportionate Share Hospitals (DSH) in California. Of the 60, the Franchise Tax Board identified 10 that were profitable. The nature of DSH is that they are minimally profitable or not profitable. FTB records show some of DSH paying just the minimum tax.

Data from SB 1953 (Alquist, Stats. 1994, Ch. 740) was used to extrapolate the income tax revenue estimate for this proposal. The cost for seismic retrofitting of DSH for this proposal was estimated at approximately $100 million per qualifying hospital, depreciated over 30 years ($100 million divided by 30 years = $3 million/year).

It was assumed that one hospital each year would retrofit beginning in 2008 through 2030. A 33% apportionment factor was applied to the revenue impact; a 6% tax rate was then applied to that result. For each qualifying hospital, a $100 million retrofit cost divided by 30 years of depreciation equals $3.3 million cost per year. Applying a 33% apportionment factor to the $3.3 million equals $1.1 million; applying a 6% tax rate to the $1.1 million equals a $66,000 depreciation deduction for each hospital.

Assuming one hospital begins retrofit each year, there would be an annual impact of $66,000 beginning in 2010, when this provision reaches full impact.

POLICY CONCERNS

This bill would provide a tax benefit for corporations that would not be provided to other business entities, such as pass-through entities and individual taxpayers. Thus, this bill would provide different treatment to different taxpayers based solely on their form of organization.

This bill does not contain a sunset date. Sunset dates generally are provided to allow periodic review by the Legislature.

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