Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Margett	Analyst:	Nicole Kwon	Bill Number:	SB 308
Related Bills:	See Legislative History	Telephone:	845-7800	Introduced Date:	February 16, 2007
		Attorney:	Daniel Biedler	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 motor 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, 2007, and ending on or before January 1 of a qualified year (as defined).

POSITION

Pending.

ANALYSIS

FEDERAL/STATE 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 truck.[1] 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 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.

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

Board Position:			Department Director	Date
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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]

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

THIS BILL

This bill would provide personal income taxpayers with a $3,000 deduction for each qualified vehicle transaction during the taxable year for each taxable year beginning on or after January 1, 2007, and before January 1 of a qualified year.

This bill would define the "qualified year" to mean the earlier of January 1, 2011, or the year that immediately follows the first year in which at least 100,000 qualified vehicles are sold and registered in the state.

This bill would define the "qualified vehicle transaction" to mean purchasing or beginning an initial lease of a qualified vehicle in the state during the taxable year.

This bill would define the "qualified vehicle" to mean a 2007 or newer model year qualified hybrid motor vehicle that meets the requirements of the federal income tax credit for hybrid vehicles.

Because this bill does not specify otherwise, this deduction would be considered a miscellaneous itemized deduction and allowed only to the extent that all miscellaneous deductions exceed 2% of adjusted gross income (AGI).

IMPLEMENTATION CONSIDERATIONS

This bill would raise the following implementation considerations.

The deduction would be available for taxable years beginning on or after January 1, 2007, and before January 1 of a qualified year. When 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.

"The year that immediately follows the first year in which at least 100,000 qualified vehicles are sold and registered in the state" on page 2, lines 11 to 13, can be interpreted as either 100,000 qualified vehicles sold in any one year or 100,000 qualified vehicles sold in cumulative years starting at 2007. The author's office may want to clarify the correct intention of the bill for the department to implement the provision of the bill.

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[2] IRC Section 30.

LEGISLATIVE HISTORY

AB 838 (Saldana, 2005/2006) would have allowed individuals and businesses that purchased "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 2616 (Nakanishi, 2005/2006) was identical to this bill. AB 2616 was held in the Assembly Revenue & Taxation 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 198 (Nation, 2003/2004), AB 848 (Nation, 2003/2004), and AB 2484 (Ridley-Thomas, 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 198 was held in Senate Appropriations, AB 848 remained in the house of origin, and AB 2484 was held in Assembly 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

<u>Revenue Estimate</u>

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

Estimated Revenue Impact of SB 308 Effective for Tax Years BOA 1/1/2007 Assumed Enactment Date After 6/30/07 ($ in Millions)		
2007/08	2008/09	2009/10
-$8	-$9	-$11

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

<u>Revenue Discussion</u>

The revenue impact of this bill is dependent on the number of hybrid vehicles, 2007 or newer models, that are sold and leased in California. The deduction is effective for January 1, 2007, and would sunset at the earlier of, the year after hybrid vehicle sales and leases total at least 100,000 during a calendar year or January 1 of a qualified year. The $3,000 deduction would be considered a miscellaneous itemized deduction and allowed only to the extent that all miscellaneous deductions exceed 2% of the taxpayer's AGI.

Based on an analysis of market projections, as well as data provided by the Air Resources Board and the Department of Motor Vehicles, qualified hybrid sales or lease are anticipated to reach and exceed the minimum threshold during 2010 and total 114,000. Annual qualified transactions would total 57,000 in 2007, 81,000 in 2008, 97,500 in 2009, and 114,000 in 2010.

Beginning in 2008, qualified transactions include purchases or leases by some taxpayers that would accelerate their hybrid purchase or leases by one year to secure eligibility of the tax benefit. Because the proposed deduction would be limited to vehicles purchased or leased by California personal income taxpayers, qualified transactions do not include purchases made in California and registered out of state, as well as corporate or government transactions.

For calendar year 2007, of the 57,000 qualified purchases, this estimate assumes that 5% or 2,850 (57,000 x 5%) taxpayers would not use the new deduction but instead, continue to use the standard deduction. Of the remaining 95% or 54,150 transactions (57,000 x 95%), some taxpayers would have adequate miscellaneous expenses to utilize the entire $3,000 and others would be limited, based on upon their AGI.

Based on a review of tax return statistics and reports on the hybrid car market, this estimate assumes that 30% or 16,245 (54,150 x 30%) transactions would result in deductions that total 100% of the $3,000 expense and in aggregate would equal $48 million (16,245 x $3,000) in deductions. This includes taxpayers that currently report miscellaneous deductions as well as those taxpayers whose miscellaneous expenses would now exceed 2% of their AGI. Additionally, deductions for the remaining 37,905 (54,150 x 70%) transactions are anticipated to be limited. Again, based on hybrid car market trends, this estimate uses an average AGI of $100,000, setting the 2% floor at $2,000 ($100,000 x 2% =$2,000). Therefore, these taxpayer would use 1/3 or $1,000 ($3,000 -$2,000= $1000) of the proposed deduction and in aggregate would equal $38 million (37,905 x $1,000) in deductions.

In summary, during 2007 annual deductions would equal $86 million ($48 million for taxpayers using the full deduction plus $38 million for taxpayers using a portion of the deduction). Applying an average marginal tax rate of 7%, revenue losses for 2007 would total $6 million ($86 million x 7%). Total qualified purchases or leases made during 2008 include 69,000 vehicles (purchases or leases that would have been made absent this proposal) and an additional 12,000 purchases or leases, resulting from anticipated altered behavior.

In the chart above, the estimate represents the revenue impact on fiscal year basis. The $8 million fiscal year revenue impact for 2007/08 includes deductions for all purchases or leases made during 2007 ($6 million) as well as adjustments to withholding for a small portion of purchases or leases made during 2008 ($2 million).

LEGAL IMPACT

This bill would require taxpayers to purchase qualified vehicles in the state to qualify for the deduction. This requirement may be subject to constitutional challenge under the Commerce Clause of the United States Constitution.

ARGUMENTS/POLICY CONCERNS

1. 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.

2. 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.

3. This bill only requires the purchase or lease of the hybrid vehicles in California but does not require the hybrid vehicle to be used in California. Thus, California could be subsidizing the use of these vehicles used outside the state by allowing the deduction.

4. As the bill is currently written, it would allow a miscellaneous itemized deduction only to the extent that it exceeds 2% of the taxpayer's AGI. The author may wish to provide a tax benefit to all taxpayers purchasing or leasing the qualified hybrid vehicles, not just those who claim itemized deductions. If so, R&TC section 17072 would need to be amended to allow a deduction in arriving at AGI.

LEGISLATIVE STAFF CONTACT

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