Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Miller	Analyst:	Matthew Cooling	Bill Number:	AB 363
Related Bills:	See Legislative History	Telephone:	845-5983	Introduced Date:	February 23, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Fire Safety Compliance Tax Credit

SUMMARY

This bill would create a tax credit for the costs incurred to bring a qualified home into fire safety compliance, as specified.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to encourage taxpayers who are not subject to current fire safety building standards to voluntarily bring their homes into compliance and to mitigate the financial burden with a tax credit.

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, 2009.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business.

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Additionally, existing federal and state laws generally provide that the original basis of property must be adjusted for expenditures that are properly capitalized, such as improvements, and for other amounts, such as depreciation.

Current state law requires landowners in mountainous, forest, brush, and grass-covered lands to maintain a 30-foot firebreak around homes, buildings, and structures. Current state law also requires that around and adjacent to an occupied dwelling or occupied structure, additional fire protection or firebreaks out to 100 feet from the dwelling or structure or to the property line be maintained. Greater distances may be required by local ordinance, rule, or regulation.

The California Civil Code defines a “dwelling unit” as a structure or the part of a structure that is used as a home, residence, or sleeping place by one person who maintains a household or by two or more persons who maintain a common household[1].

Current state law also defines the following:

- “Fire Hazard Severity Zone” means a geographical area designated by the director of the California Department of Forestry and Fire Protection (CDF)[2].
- Local Agency Very High Fire Hazard Severity Zone means an area designated by a local agency on the recommendation of the CDF director[3].
- Wildland-urban interface fire area is a geographical area identified by the state as a “Fire Hazard Severity Zone[4].”

THIS BILL

For taxable years beginning on and after January 1, 2009 and under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), this bill would allow a tax credit in an amount equal to the qualified costs to bring a qualified home into compliance with the fire hazard severity zone, local agency very-high fire hazard severity zone, or wildland-urban interface fire area building requirements. The credit would be allowed for the taxable year in which a qualified home is brought into compliance. Any unused credit would be allowed to be carried over into the succeeding years until it is exhausted.

This bill would define “qualified costs” as costs paid or incurred for the construction, repair, maintenance, rehabilitation, or improvement of a qualified home to bring the home into compliance with current fire safety regulations imposed on new construction.

This bill would define a “qualified home” as a dwelling unit located in a fire hazard severity zone, local agency very-high fire hazard severity zone, or wildland-urban interface fire area that is not a new building subject to current fire safety compliance regulations for new construction.

[1] California Civil Code section 1940(c).
[2] Public Resources Code sections 4201 through 4204.
[3] Government Code sections 51177(c), 51178, and 51189.
[4] Public Resources Code sections 4201 through 4204 and Government Code sections 51175 through 51189.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill uses undefined terms such as, "the year in which a qualified home is brought into compliance," "construction," "repair," "maintenance," "rehabilitation," "new building," and "improvement." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

In addition, without defining these terms, it is unclear how the department would determine that the improvements made to the qualified home are general home improvements instead of improvements necessary to increase fire safety compliance. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. It is recommended that the author amend the bill to clarify that the credit can be used for costs paid or incurred for home improvements necessary to bring a qualified home, which would not otherwise be subject to current building requirements, into compliance with current regulations, as certified by the local building authority on final completion.

This bill fails to define "dwelling unit," "fire hazard severity zone," "local agency very-high fire hazard severity zone," and "wildland-urban interface fire area." It is recommended that the author define these terms to avoid disputes that may arise related to the location of qualified homes. The author may wish to reference the provisions of the California Civil Code, the Public Resources Code, and the Government Code referenced in the current state law analysis above.

LEGISLATIVE HISTORY

AB 294 (Anderson, 2009/2010) would allow a deduction for the qualified costs paid or incurred during the taxable year by a qualified taxpayer to create a defensible space, as defined, around a qualified property, as defined, by removing all brush, flammable vegetation, and combustible growth within 100 feet of certain structures on that property. This bill has been read in the Assembly.

AB 424 (Gaines, 2007/2008) would have allowed taxpayers a credit equal to, but no greater than $500, for qualified costs incurred for creating a defensible space around an existing home. This bill failed to pass out of the Senate Revenue and Taxation Committee.

AB 1912 (Plescia, 2007/2008) would have provided a credit in an amount equal to 15 percent of the costs paid or incurred by a taxpayer for the purchase and installation of any wildfire risk reduction improvement installed on existing property in this state. This bill failed to pass out of the Assembly Revenue and Taxation Committee.

AB 914 (Battin, 2001/2002) would have allowed taxpayers a credit of 20 percent of the cost incurred, not to exceed $1,000, for replacing the roof of a qualified residence with a fire retardant roof. This bill failed to pass the first house by the constitutional deadline.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the one that would be allowed by this bill. These states were selected due to their 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 but are anticipated to be minor.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 363 Effective On or After January 1, 2009 Enactment Assumed After June 30, 2009 ($ in Millions)			
Fire Safety Compliance	2009-10	2010-11	2011-12
	-$230	-$350	-$485

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

Revenue Discussion

The revenue impact of this bill would depend on the number of qualified taxpayers in the specified fire zones that incur qualified costs, the amount of those costs, and the amount of credits that can be applied to reduce tax liabilities. The credit would be claimed for the costs of remodeling to bring residences up to current fire safety codes.

The International Journal of Wildland Fire shows approximately 5.1 million qualified California homes in 2000. The number of qualified homes was projected to be approximately 5.6 million homes in 2009. If 1 percent of qualified homes, or approximately 56,000 property owners (5.6 million x 1%) each year incur an average of $10,000 in qualified costs for construction, repair, rehabilitation, or improvements, qualified costs would be approximately $560 million (56,000 property owners x $10,000 qualified costs). Additional credits generated would equal these additional qualified costs incurred, or $560 million.

It is assumed one-third is applied to reduce tax liabilities in the year generated, creating the potential annual loss of approximately $185 million ($560 million x 33%). It is assumed that unused credits would be used ratably over a four-year period. In each successive year, applied credits would increase due to the build up of carryover credits.

Revenue losses are converted to fiscal years: $230 million in 2009-10, $350 million in 2010-11 and $485 million in 2011-12.

POLICY CONCERNS

This bill does not limit the number of years for the carryover period. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits typically are exhausted within eight years of being earned.

Generally, credits are limited as a percentage of amounts paid or incurred. This bill would allow a 100 percent credit, which is unprecedented.

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

Conflicting tax policies come into play whenever a credit is provided for an item that is already deductible as a business expense or is otherwise reflected as an adjustment to the basis of property for tax purposes. This bill would provide a credit and allow the full amount to be deducted or added to basis for improvements made to a qualified home. This would have the effect of providing a double benefit for that item or cost. On the other hand, making an adjustment to deny the deduction or reduce basis in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy.

LEGISLATIVE STAFF CONTACT

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