Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Simitian	Analyst:	William Koch	Bill Number:	SB 425
Related Bills:	See Legislative History	Telephone:	845-4372	Amended Dates:	April 13, 2009 & April 16, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Commute Expenditures Reduction Credit/Parking Subsidy Deduction Disallowed Unless All Employees Are Offered Parking Cash-Out

SUMMARY

This bill would allow a tax credit for qualifying expenses relating to commute reduction and disallow the deduction of parking subsidies.

SUMMARY OF AMENDMENTS

The April 13, 2009, amendments deleted provisions modifying the Health and Safety Code as introduced February 26, 2009, and added provisions that would allow a tax credit for qualifying expenses relating to commute reduction and disallow the deduction of parking subsidies.

The April 16, 2009, amendments deleted provisions that would have required the Franchise Tax Board (FTB) to allocate the tax credit on a first come, first serve basis and deleted other related provisions regarding FTB's administration of the tax credit.

This analysis addresses the bill as amended April 16, 2009, and is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to reduce single occupancy trips, alleviate congestion, and provide small businesses with an incentive to increase transportation demand management strategies.

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.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
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_______ N	_______ OUA	___X___ PENDING		

Summary of Suggested Amendments

Amendment 1 is provided to correct a technical error.

Provision 1: Tax Credit for Commute Reduction Expenditures

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws allow taxpayers to deduct ordinary and necessary business expenses, which generally would include providing commuter benefits to employees.

Current federal and state law allows employees certain exclusions from gross income for the value of employer-provided commuter transportation subsidies, including transit passes and qualified parking. Employees generally cannot deduct their regular costs of commuting to and from their place of business under either federal or state law.

Current state law allows an employee to exclude from gross income the amount of compensation or the fair market value of any benefit (except salary or wages) received from an employer for participation in any ride-sharing program in California, including the value of a monthly transit pass for use by the employee or his or her dependents.

Existing federal and state 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 federal and state laws do not provide a credit for expenses relating to commute reduction.

For the taxable years 1989 through 1995, state law provided a tax credit for vanpool and third-party ridesharing expenses.

Under current state law, for taxable years beginning on or after January 1, 2008, and before January 1, 2010, the total of all business credits otherwise allowable may not exceed 50 percent of the net tax of the taxpayer for that taxable year. Taxpayers with net business income of less than $500,000 are excluded from this limitation.

In addition, current state Corporation Tax Law allows the assignment of certain credits to taxpayers that are members of a combined reporting group and adds the following provisions:

- Provides that an "eligible credit" may be assigned by a taxpayer to an "eligible assignee."

  • "Eligible credit" means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, which is eligible to be carried forward to the taxpayer's first taxable year beginning on or after July 1, 2008.

  • "Eligible assignee" means any "affiliated corporation" that is a member of a combined reporting group at certain specified times.

  • "Affiliated corporation" means a corporation that is a member of a combined reporting group.

- Provides that the election to assign any credit is irrevocable once made and is required to be made on the taxpayer's original return for the taxable year in which the assignment is made.

<u>THIS PROVISION</u>

For taxable years beginning on or after January 1, 2009, this provision would allow specified taxpayers to claim a credit under personal income and corporate tax law equal to the lesser of $1,500 or 80 percent of the costs paid or incurred during the taxable year by that specified taxpayer, as defined, for qualified commute reduction expenditures.

This provision would do the following:

- Define a "taxpayer" as a person or entity engaged in a trade or business within California who employs a maximum of 20 full-time employees, as specified. The definition of a "taxpayer" would specifically exclude the state, a county, a city, a city and county, a special district as specified, a school district, a community college district, the California State University, or the University of California.

- Define "qualified commute reduction expenditures" as costs paid or incurred by the taxpayer for any of the following:

  1. Subsidizing employees commuting in:

     - vanpools, as defined
     - private commuter buses or buspools, as defined
     - subscription taxipools, as defined
     - a carpool, as defined
     - a ferry

2. Subsidizing monthly transit passes for its employees or use by the employee's dependents, as specified.

3. Providing free or subsidized parking to carpools, vanpools, or any other vehicle used in a ridesharing arrangement within California.

4. Making facility improvements to encourage employees, for the purpose of commuting from their home, to use bicycles.

5. Making facility improvements to encourage employees to use an alternative transportation method, or subsidizing employees who already uses an alternative transportation method, as specified, that reduces the use of a motor vehicle by a single occupant to travel to or from that employee's place of employment.

6. Subsidizing employees who travel to or from a telecommuting facility.

- Allow the credit to be carried over until exhausted.

- Require the credit to be in lieu of any deduction otherwise allowable for the same costs.

- Provide FTB with the authority to prescribe rules, guidelines, or procedures necessary or appropriate to administer the credit. The rules, guidelines, and procedures would be exempt from the Administrative Procedures Act regarding regulations.

IMPLEMENTATION CONSIDERATION

The department has identified the following implementation concern for this provision of the bill. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

This provision defines a "taxpayer" as a person or entity engaged in a trade or business within California who employs a maximum of 20 employees. This provision fails to indicate a set date to determine the number of employees a taxpayer employs, which could lead to disputes between the department and taxpayers. It is recommended this provision be amended to resolve this issue.

TECHNICAL CONSIDERATION

On page 3, line 4, and page 6, line 7, the word "deduction" is incorrectly used instead of the word "credit". Amendment 1 is provided to correct this error.

LEGISLATIVE HISTORY

AB 2128 (Torrico, 2005/06) would have allowed employers a tax credit for providing commuter benefits to their employees. This bill failed to pass out of the Assembly Revenue & Taxation Committee.

AB 547 (Figueroa, 2001/02) would have allowed employers a tax credit for providing subsidized public transit passes to their employees. This bill was held in the Assembly Revenue and Taxation Committee.

SB 1427 (Rainey, 1999/2000) also would have allowed a tax credit for an employer who subsidized public transit passes. This bill failed to pass out of the Senate Revenue and Taxation Committee.

AB 171 (Cunneen, 1997/1998) would have allowed a tax credit for an employer who subsidized its employees' public transit passes or subsidized monthly vanpool fare. This bill failed to pass out of the Assembly Appropriations Committee.

AB 1702 (Figueroa, 1997/1998) would have allowed a tax credit for an employer who subsidized public transit passes. This bill failed to pass out of the Assembly Appropriations Committee.

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.

Illinois allows taxpayers to deduct, if included in adjusted gross income, ride-sharing or other benefits received by a driver in a ridesharing arrangement.

Massachusetts provides a tax credit equal to 30 percent of the total purchase or lease costs for shuttle vans used in an employer-sponsored ridesharing program.

Minnesota provides a tax credit equal to 30 percent of the difference between the price the employer paid for a transit pass and the price charged to an employee for a transit pass.

Florida, *Michigan*, and *New York* do not provide a credit similar to the credit this provision would allow.

FISCAL IMPACT

This provision would not significantly impact the department's costs if the implementation consideration addressed in this analysis is resolved.

ECONOMIC IMPACT

Revenue Estimate

Based on the data and assumptions discussed below, this provision would result in the following revenue losses beginning in 2009.

Estimated Revenue Impact of Provision 1 - SB 425 Assumed Enactment after 6/30/09 Assumed Effective for Taxable Years Beginning on or after 01/01/09 ($ in Millions)			
	2009/10	2010/11	2011/12
Commute Reduction Tax Credit	-$25	-$23	-$25

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision.

Revenue Discussion

The revenue impact of allowing a new tax credit for qualified commute expenses depends on the amount of qualified expenses incurred by businesses that employ up to 20 employees.

Based on a review of federal estimates for employer related transportation fringe benefits, total California employer-paid expenses are estimated to total $2.4 billion. Based on supporting federal and California Employment Development Department data, it is estimated that about 15 percent or $365 million of total employer-paid transportation fringe benefits would meet the definition of a qualified expense, but only 20 percent or $73 million of these expenses would be paid by qualified employers. Total expenses are increased by 10 percent to $80 million to account for other facility improvement expenses, as specified within the bill. Applying the credit limit of 80 percent of qualified expenses results in $64 million ($80 million x 80%) in total credits generated during taxable year 2009. After limiting qualified expense to 80 percent of costs, it is anticipated that some employers' expenses would exceed this provision's maximum credit of $1,500. Therefore, it is estimated that one-half, or $32 million of costs would represent those costs that fall below the credit limit.

Since under current law an employer is allowed to deduct transportation expenses, total credits generated are reduced by $2.5 million, to $29.5 million to account for this existing deduction. It is estimated that only 70 percent of credits will be applied to reduce a taxpayer's liability in the first year, and 5 percent each in the four subsequent years. Therefore, for 2009, it is estimated that $21 million of credits will be used ($29.5 million x 70% usage).

The revenue in the chart assumes that this bill is enacted after June 30, 2009, and therefore the entire impact for taxable year 2009 would show during fiscal year 2009/10. This fiscal year would also include a slight reduction in estimated tax payment for credits generated during taxable year 2010.

POLICY CONCERNS

The credit this provision would allow lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a credit or subsidy by the Legislature.

The credit this provision would provide allows for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

Provision 2: Parking Subsidy Deduction Disallowed

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws allow taxpayers to deduct ordinary and necessary business expenses, which generally includes providing fringe benefits, such as parking subsidies, to employees.

Current state law, known as California's parking cash-out program, and administered by the California Air Resources Board (CARB), requires certain employers who provide subsidized parking for their employees to offer a cash allowance in lieu of a parking space.[1] California's parking cash-out program, in general, requires employers of 50 or more employees in an air basin designated nonattainment for any state air quality standard to offer a parking cash-out program to those employees who have the availability of employer subsidized parking. Employer violations of the parking cash-out program are subject to civil penalties not to exceed $500 per civil action.[2]

THIS PROVISION

For employers subject to California's parking cash-out program, this provision would prohibit a business expense deduction for parking subsidies unless all employees provided with a parking subsidy are offered a parking cash-out program in accordance with California's parking cash-out program.

This provision would do the following:

- Provide that the phrases "parking subsidy" and "parking cash-out program" mean the same as those phrases are defined under Health and Safety Code section 43845.
- Apply to taxable years beginning on or after January 1, 2009.
- Apply to personal income and corporate taxpayers.

[1] Health and Safety Code section 43845
[2] Health and Safety Code section 43016

IMPLEMENTATION CONSIDERATION

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

This provision would prohibit the deduction of parking subsidies for employers subject to, but not in compliance with, California's parking cash-out program. FTB lacks expertise to easily determine if an employer is subject to, but not in compliance with, this program. It is recommended that the author amend the bill to require CARB, the entity responsible for administering the program, to make this determination and notify FTB of noncompliant employers.

LEGISLATIVE HISTORY

SB 728 (Lowenthal, 2009/2010) would allow cities, counties, and air districts the authority to establish a penalty or mechanism to ensure employers comply with California's parking cash-out program. This bill is set for hearing in the Senate Environmental Committee.

AB 2109 (Katz, Stats. 1992, Ch. 554) created California's parking cash-out program.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not contain statutes similar to this provision. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

This provision would not significantly impact the department's costs if the implementation consideration addressed in this analysis is resolved.

ECONOMIC IMPACT

Revenue Estimate

Based on the data and assumptions discussed below, this bill would result in the following revenue gains beginning in 2009.

Estimated Revenue Impact of Provision 2 - SB 425 Assumed Enactment after 6/30/09 Assumed Effective for Taxable Years Beginning on or after 01/01/09			
	2009/10	2010/11	2011/12
Denied Deductions	$3,100,000	$3,200,000	$3,300,000
Taxable Compensation	$40,000	$150,000	$300,000

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision.

<u>Revenue Discussion</u>

The revenue impact of this provision is determined by combining the following revenue streams:

1. The revenue gain due to taxable parking cash-out payments.
2. The revenue gain due to denial of deductions for employers that fail to offer employees cash in lieu of a qualified parking space.

This provision would prohibit parking subsidy deductions for employers who are currently subject to California's parking cash-out program and fail to offer their employees cash in-lieu of a qualified parking space. Based on a study conducted by the Legislative Analyst Office during 2002 and applying a growth rate, it is estimated that during 2009 about 333,000 parking spaces would fall under California's parking cash-out program. This estimate assumes an 80 percent occupancy rate, reducing the number of parking spaces to 266,000.

Although employer behavioral response to this provision is unknown, it is anticipated that employers would either: 1) offer other transportation commuter fringe benefits, 2) offer cash in lieu of a parking space, or 3) fail to offer cash in lieu of a parking space and forego related tax deductions. It is assumed that 40 percent of such parking spaces represent employers that become compliant by offering alternative transportation benefits and that 30 percent of parking spaces represent employers that become compliant by offering cash in lieu of a parking space. The remaining 30 percent of parking spaces represent employers that would fail to offer cash in lieu of a parking space and forgo related tax deductions.

Group A – Employers that become compliant by offering other transportation commuter benefits would have no revenue implications.

Group B – Employers that offer cash in lieu of a parking space. For this group, any cash received by employers would be classified as taxable income. Based on a review of cash-out program literature, it is assumed that 12 percent of employees offered cash would take advantage of the program. This means that of the 80,000 employees associated with this group, 12 percent, or approximately 9,600 employees, would opt for cash payment (266,000 x 30% x 12%). California taxpayers are able to forgo reporting this income as long as the cash payment is used for ridesharing purposes. It is estimated that about 70 percent of payments would fall under this exception, leaving 30 percent, or 2,880 parking spaces, where cash is offered that would be subject to state income taxes. Assuming an annual expense of $2,800 (240 x 12 months) and an average marginal tax rate of 5 percent, this portion of the provision would result in a revenue gain of $400,000 (2,880 parking spaces x $2,800 annual expense x 5%) once fully implemented. For tax year 2009, since it will take time for employers to opt out of their parking leases to offer cash, the revenue gain for the first year is estimated to total approximately 10 percent or $40,000.

Group C- Employers that fail to offer cash payment in lieu of a parking space and forego related parking subsidy deductions. Assuming that employers incur an annual expense of $2,800 for the 80,000 parking spaces that are associated with this group, and after taking into account businesses that solely conduct business in California and those that apportion their income, about $76 million in deductions are estimated to be denied under this bill. Assuming an average marginal tax rate of 4 percent, this portion of the provision would result in a revenue gain of approximately $3 million in fiscal years 2009/10, 2010/11 and 2011/12.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 425
As Amended April 16, 2009

AMENDMENT 1

On page 3, line 4, and page 6, line 7, strikeout "deduction" and insert:

credit