Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Hagman	Analyst:	Jane Raboy	Bill Number:	AB 1015
Related Bills:	None	Telephone:	845-5718	Introduced Date:	February 22, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Joint Occupancy Agreements with School Districts Credit

SUMMARY

This bill would, under the Education Code, create two tax credits for developers, contractors, investors, or combination of private sector partners that enter into certain agreements with school districts.

This bill would also modify other sections of the Education Code. This analysis is limited to the changes that would impact the department.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to encourage developers, contractors, investors, or private partners to execute a joint occupancy agreement or infrastructure agreement with school districts.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2014, and specifically operative for taxable years beginning on or after January 1, 2014.

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.

Existing state and federal law does not have a credit comparable to that proposed in this bill.

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Current state and federal law generally allow a taxpayer engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business, unless specifically excluded by statute.

<u>THIS BILL</u>

For taxable years beginning on or after January 1, 2014, this bill would create two new tax credits, under the Education Code, for a developer, contractor, investor, or combination of private sector partners, (collectively for purpose of this analysis referred to as "Developer") that enter into a joint occupancy and infrastructure agreement.

1. Joint Occupancy Tax Credit

This bill would create an income and franchise tax credit as follows for a Developer that executes a joint occupancy agreement with the governing board of a school district.

Beginning in the first taxable year of construction, as demonstrated by a construction contract for all or a portion of the joint occupied property of the school district, the joint occupancy tax credit would be equal to 8 percent of the total cost to the Developer of the joint occupancy project for the first four taxable years and 6 percent of the total cost to the Developer of the joint occupancy project for three subsequent taxable years if the joint occupancy agreement requires the Developer to contribute at least 50 percent of the cost for any of the following:

- Certified rehabilitation of certified historic structures on the school site of the joint occupancy facility or at a different school site location within the geographical boundaries of the school district or county office of education.
- Renewing, rehabilitating, repairing, or replacing non-historic schools, classrooms, ancillary at a different school site location within the geographical boundaries of the school district or county office of education.

Beginning in the first taxable year of construction of a joint occupancy project, the joint occupancy tax credit would also be equal to 8 percent of the total cost to the Developer of the joint occupancy project for the first four taxable years and 6 percent of the total cost to the Developer of the joint occupancy project for three subsequent taxable years.

2. Infrastructure Tax Credit

This bill would create an income and franchise tax credit for a Developer that executes an agreement with the governing board of a school district to purchase, lease, or exchange, school property, consistent with applicable bills of law, if the agreement requires the Developer to provide financing, preconstruction services, or construction services that address infrastructure needs at one or more properties of the school district.

Beginning in the first taxable year of an agreement for services related to infrastructure needs of the school district that include, but are not limited to, financing, environmental or seismic investigations, architectural or engineering services, or construction the tax credit would be equal to 8 percent of the total cost to the Developer of the services required by the agreement for the first four taxable years and 6 percent of the total cost to the Developer of the services required by the agreement for three subsequent taxable years.

Additionally, this bill would authorize a school district or county office of education to establish a nonprofit organization exempt from taxation pursuant to Section 501(c)(3) of the Internal Revenue Code for purposes of receiving and managing tax-deductible donations.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high level discussion; additional concerns may be identified as the bill moves through the legislative process.

This bill would create new state income and franchise tax credits under the Education Code. The Franchise Tax Board (FTB) is responsible for administering and enforcing the Revenue and Taxation Code (R&TC).[1] As a result, the FTB would be unable to administer these credits if the statutory language remains under the Education Code. Accordingly, this bill should be amended to place the income and franchise tax credit bills appropriately within the Parts of the R&TC administered by the FTB.

The terms and phrase, “developer,” “contractor,” “investor,” and “combination of private sector partners,” used to identify the entity eligible for the income and franchise tax credits this bill would create are undefined. Additionally, the terms “taxpayer" and "qualified taxpayer" are the customary terms used within a franchise or income tax credit statute to identify the entity eligible to claim and apply a tax credit against a tax liability. Therefore, those terms have the benefit of past usage and common understanding within the context of a tax credit statute and for consistency and harmony with other tax credit language should be used in credit bills that are placed within the Personal Income Tax Law and Corporation Tax Law.

This bill uses phrases that are undefined, i.e., “joint occupancy agreement,” “joint occupancy project,” “joint occupied property,” “joint occupancy facility,” “preconstruction services,” and “construction services.” The absence of definitions to clarify these phrases could lead to disputes with taxpayers and would complicate the administration of this credit.

It is unclear whether and to what extent a joint occupancy project could meet the specifications for both types of creditable project and how the credit would be calculated in this situation. Lack of clarity could cause disputes between taxpayers and the administering department and would complicate the administration of this credit.

The department lacks expertise in a number of areas that this bill addresses including, certified rehabilitation, historic structures, engineering and architectural reporting requirements, financing, and construction. Because the department lacks this expertise it would be difficult to determine that the requirements for the credit have been met.

This bill would allow a school district or county office of education to establish a nonprofit organization for purposes of receiving and managing tax-deductible donations. It is unclear how a “Developer” would be allowed a deduction for the contribution in addition to the credit. It is also unclear how or whether the language disallowing a contribution deduction for amounts included in the determination of the credit would apply if a credit is certified for the taxable year subsequent to the year the donation is made.

[1] The FTB is responsible to administer Part 10, Part 10.2, Part 10.7, and Part 11 of the Revenue Taxation Code.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit allowed by this bill. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved. As the bill continues to move through the legislative process and the implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 1015 For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013 ($ in Millions)		
2013-14	2014-15	2015-16
-$130	-$380	-$410

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

LEGAL IMPACT

This bill would restrict these tax credits by granting eligibility based on joint occupancy leases and agreements for facilities located in California. This bill could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to improperly favor in-state activity over out-of-state activity. On August 28, 2012, (*Cutler* v. Franchise Tax Board), the Court of Appeal issued a unanimous opinion holding that California's Qualified Small Business Stock statutes were unconstitutional. Specifically, the Court of Appeal held that the statutory scheme's requirement of a large California presence in order to qualify for an investment incentive discriminated against interstate commerce, and therefore violated the federal dormant commerce clause. While no court decision has yet invalidated, as a general matter, state income tax credits that provide an incentive for in-state activity, i.e., property placed in service in the state, employees employed in the state, etc., targeted tax credits such as the ones proposed by this bill may be subject to constitutional challenge.

SUPPORT/OPPOSITION[2]

Support: Coalition for Adequate School Housing (Sponsor).

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that that by allowing school districts to partner with the private sector the schools may be better able to manage their assets when funding levels are uncertain.

Opponents: Some may argue that allowing a credit based on expenses deductible as ordinary and necessary business expenses is an unnecessary incentive and could compromise the state's fragile economic recovery.

POLICY CONCERNS

This bill lacks carryover language. As a result, any unused credit would be lost if the taxpayer is unable to use the entire credit amount in the year claimed. The author may wish to add language allowing a limited carryover period.

This bill would allow a credit for services and expenses that are currently deductible as business expenses. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense.

This bill fails to limit the amount of the credit that may be taken. Credits that could potentially be quite costly are sometimes limited either on a per-project or per-taxpayer basis.

LEGISLATIVE STAFF CONTACT

Jane Raboy	Mandy Hayes	Jahna Carlson
Legislative Analyst, FTB	Revenue Manager, FTB	Acting Asst. Legislative Director, FTB
(916) 845-5718	(916) 845-5125	(916) 845-5683
jane.raboy@ftb.ca.gov	mandy.hayes@ftb.ca.gov	jahna.carlson@ftb.ca.gov

[2] As provided by the Assembly Member Curt Hagman's Assembly Bill 1015 Fact Sheet as of April 2, 2013.