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**Franchise Tax Board**

**ANALYSIS OF AMENDED BILL**

Author: Daly Analyst: Jane Raboy Bill Number: AB 893

Related Bills: See Legislative History Telephone: 845-5718 Amended Date: March 14, 2013

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Mello-Roos Deduction

**SUMMARY**

This bill would allow a deduction under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL) for Mello-Roos Community Facilities Fees (Mello-Roos Fees).

**RECOMMENDATION**

No position.

**Summary of Amendments**

The March 14, 2013, amendments removed provisions of the bill related to sales and use tax, and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill.

**REASON FOR THE BILL**

The reason for this bill is to statutorily allow amounts paid pursuant to the Mello-Roos Community Facilities Act of 1982 as a deduction on a state income or franchise tax return.

**EFFECTIVE/OPERATIVE DATE**

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

**ANALYSIS**

**PROGRAM BACKGROUND**

In 1982, the California Legislature enacted the Mello-Roos Community Facilities Act. The Act allows any county, city, special district, school district or joint powers authority to establish a "Community Facilities District" (District) which allows for the financing of public services and facilities. Mello-Roos Fees can be for both specific benefits and for things that benefit other property owners as well. For example, services for the general public welfare include police and fire protection, streets, schools, parks, and libraries. A District is authorized to sell tax-exempt bonds to fund such local improvements and then assess a special tax (Mello-Roos Fees tax)

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against property within the District to repay the bonds. Typically, the property that is assessed is one of the properties that receive the benefits, either through use of services and facilities or increases in property value. This type of tax is distinguished from regular real property taxes that are levied purely for the general public welfare and at the same (ad valorem) rates on all properties within the jurisdiction. The Mello-Roos Fees tax is usually included on the annual County property tax bill sent to taxpayers.

On February 6, 2012, the Internal Revenue Service Office of the Chief Counsel (IRS Chief Counsel) in response to a letter from the Franchise Tax Board concluded that the deductibility of California Mello-Roos and other assessments may be deductible as real property taxes even though the Mello-Roos Fee is not imposed on an ad valorem basis. Specifically, assessments on real property owners, based other than on the assessed value of the property, may be deductible if they are levied for the general public welfare by a proper taxing authority at a like rate on owners of all properties in the taxing authority's jurisdiction, and if the assessments are not for local benefits (unless for maintenance or interest charges).

### FEDERAL/STATE LAW

Existing federal and state laws generally allow a taxpayer to deduct any state, local, or foreign real property taxes imposed on property owned by the taxpayer and paid or accrued by the taxpayer during the taxable year. Individuals are allowed to deduct from their adjusted gross income either a fixed amount (indexed for inflation), known as the standard deduction, or the amount of a taxpayer's itemized deductions, whichever is greater. Certain expenses, such as property taxes, medical expenses, charitable contributions, interest, and taxes, are deductible as itemized deductions. In addition, federal and state 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.

Deductible real property taxes must be based on the assessed value of the property, commonly referred to as an ad valorem or general tax levy, and the taxes must be charged uniformly against all properties in the jurisdiction. These ad-valorem taxes are usually identified on a property tax bill as an amount that includes a tax rate percentage. Generally, a taxpayer may not deduct Mello-Roos Fees or any other assessment, charge, or special assessment for local benefits (such as streets, sidewalks, and other like improvements) of a kind tending to increase the value of the property assessed that are imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, unless the assessment or charge is made for the purpose of maintenance or repair, or for the purpose of meeting interest charges with respect to those local benefits. In the case of property used in a trade or business or property held for the production of income, an assessment, charge, or special assessment for local benefits imposed upon such property is deductible by a taxpayer as a business expense.

An assessment, charge, or special assessment for local benefits is usually identified on a property tax bill as an amount that does not include a tax rate percentage. These assessments may include, but are not limited to, the following:

- Mello-Roos Community Facilities Districts
- 1915 Assessment District Bonds
- Parcel taxes, fee, and charges
- Lighting and landscape
- School or college measures and bonds
- Water, sewer, and flood
- Police and fire
- Libraries

### THIS BILL

Beginning on or after January 1, 2014, this bill would allow a deduction under the PITL and CTL for the amount paid by a taxpayer under the Mello-Roos Community Facility Act of 1982.

### IMPLEMENTATION CONSIDERATIONS

This bill would allow “a deduction” for Mello-Roos Fees paid by an individual. Property taxes are generally allowed as an “itemized deduction” for Personal Income Tax purposes instead of as “a deduction.” If it is the author’s intent to treat a Mello-Roos Fee as an itemized deduction, an amendment would be necessary.

### **LEGISLATIVE HISTORY**

AB 1552 (Silva, 2011/2012) contained provisions similar to the provisions discussed in this analysis. The bill failed to pass from Committee on Revenue and Taxation by the constitutional deadline.

### **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, Michigan, Minnesota* and *New York* allow for a credit or a deduction for corporations and individuals based on the ad valorem property taxes paid or incurred without the inclusion of special assessments paid or incurred; this is the same basis from which the California property tax deduction is determined. In addition, *Illinois* requires a personal income taxpayer to provide the parcel number of the real property for which the ad valorem tax was paid or incurred in order to be eligible for the property tax credit.

*Massachusetts* allows for a corporate income tax deduction based on the ad valorem property taxes paid or incurred; the same basis from which the California property tax deduction is determined. *Massachusetts* also allows a personal income tax credit that is based on the ad valorem property taxes paid or incurred by the taxpayer as well as a portion of the water and sewer fees paid or incurred by the taxpayer.

*Florida* allows for a corporate income tax deduction based on the ad valorem property taxes paid or incurred; this is the same basis from which the California property tax deduction is determined. Florida does not impose a personal income tax.

**FISCAL IMPACT**

This bill would not significantly impact the department's costs.

**ECONOMIC IMPACT**

Revenue Estimate

Estimated Revenue Impact of AB 893 As Amended March 14, 2013 For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013 (\$ in Millions)		
2013-14	2014-15	2015-16
-\$10	-\$18	-\$19

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

**SUPPORT/OPPOSITION**

Support: None provided.

Opposition: None provided.

**ARGUMENTS**

Proponents: Supporters may say that Mello-Roos Fees are assessed on real property owners for similar purposes as ad valorem property taxes. This bill would provide equitable tax treatment between both assessments.

Opponents: Some may say that creating a new difference between federal and state law would increase the complexity of the California tax return.

## **POLICY CONCERNS**

This bill would create differences between federal and California tax law, requiring taxpayers to review closely their property tax bills to calculate two different deduction amounts for the federal and state income tax returns, thereby increasing the complexity of California tax return preparation.

## **LEGISLATIVE STAFF CONTACT**

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