Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Galgiani	Analyst:	Davi Milam	Bill Number:	SB 627
Related Bills:	See Legislative History	Telephone:	845-2551	Introduced Date:	February 27, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Refundable Commuting Miles Credit

SUMMARY

This bill, under the Personal Income Tax Law (PITL), would create a refundable credit for commuting.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to provide tax relief to working families who commute.

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, 2015.

FEDERAL/STATE LAW

Commuting expenses are generally considered nondeductible personal expenses.

There are currently no federal or state credits comparable to the credit this bill would create.

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 law provides a credit for eligible transportation costs incurred in connection with the donation of agricultural products to a nonprofit charitable organization. The credit is limited to 50 percent of costs determined based on actual costs or $.14 (fourteen cents) per mile. The nonprofit must certify that the donation meets provisions of the California Food and Agricultural Code.

Board Position:						Executive Officer	Date
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Existing state law provides general provisions regarding the calculation of credits for part year and non-residents. In addition, it provides that adjustments of refundable credits are made as math error adjustments[1], not refund claim denials. Taxpayers must file a separate new refund claim if they disagree with the adjustment.

Individuals with income below the filing thresholds are not required to file an income tax return because the standard deduction and personal exemption credit eliminate any tax liability. For 2014, these filing thresholds are $16,047 in gross income or $12,838 in adjusted gross income (AGI) for single taxpayers and $33,097 in gross income or $25,678 in AGI for married filing joint taxpayers. These filing thresholds are increased based on the number of dependents claimed and are adjusted annually for inflation.

R&TC section 41 requires any new tax credit legislation introduced on or after January 1, 2015, to include specific goals, purposes, objectives, and performance measures.

THIS BILL

For each taxable year beginning on or after January 1, 2015, this bill would allow a credit equal to the total number of the taxpayer's commuting miles for the taxable year multiplied by $______.

This bill would provide that commuting miles would be determined in the same manner as those miles are determined as nondeductible personal expenses under sections 162[2] and 262[3] of the Internal Revenue Code (IRC).

Any credit in excess of "net tax" could be carried over to succeeding taxable years until exhausted.

This bill would provide that notwithstanding the carryover provision, any allowable credit in excess of state tax liability would be credited against other amounts due, if any, and the balance, upon appropriation by the Legislature, and in consultation with the Air Resources Board (ARB), would be paid from the _________ fund and paid to the taxpayer.

This bill would provide that any credit paid to the taxpayer would not be included in income subject to tax.

This bill would allow the Franchise Tax Board (FTB) to prescribe rules, guidelines, or procedures as necessary or appropriate, and would exempt the FTB from the Administrative Procedure Act for purposes of administering this section.

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[1] Revenue and Taxation Code (R&TC) section 19052.
[2] IRC section 162 generally allows for the deduction of all ordinary and necessary expenses paid or incurred in carrying on any trade or business, including the cost of operating an automobile for that trade or business.
[3] IRC section 262 states that except as otherwise expressly provided, personal, living, or family expenses are not deductible.

This bill also would provide that a provision of existing law[4], requiring a bill introduced to authorize a new tax credit to include specific goals, purposes, objectives, and performance measures, would not apply.

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.

The FTB's Enterprise Data to Revenue (EDR) tax system modernization project will be operational and tested by process year 2017. EDR and other information systems would require new functionality to process returns with refundable tax credits. The earliest the FTB could implement a refundable credit of this magnitude without causing risk to the EDR project would be after process year 2017.

Absent a mileage rate for the computation of the credit, the department would be unable to implement the bill or develop an economic impact.

The definition of commuting miles is unclear and the referenced IRC sections[5] fail to provide a clear definition of commuting miles for purposes of the proposed credit. The absence of a definition to clarify the term could lead to disputes with taxpayers and would complicate the administration of this credit.

Additionally, the bill is silent as to an expense being paid or incurred by the taxpayer, the type of vehicle that may be used for commuting, or the mode of transportation (walking, cycling, public transit, carpool, etc.) that would be eligible for the credit. Thus, all miles would be creditable regardless of the actual cost to the taxpayer, the type of vehicle, or the mode of transportation. If this is contrary to the author's intent, the bill should be amended.

This bill would provide an unlimited carryover period for excess credits. In addition, the bill would require the department to provide refunds, upon appropriation by the Legislature. It is unclear how the carryover and refund provisions would interact. In addition, for any year in which the Legislature makes an appropriation that is insufficient to cover all of the refunds due, it is unclear whether the department would suspend payment of the refunds until additional funds were appropriated, or apply the credit's carryover provision. If the refunds were suspended, interest would have to be paid to refund recipients for the period the refund was delayed. This delay would result in additional contacts to the department by refund recipients, which would likely increase departmental costs.

Additionally, it is unclear what the consultation role of the ARB is and whether the FTB must seek approval from the ARB prior to issuing refunds.

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[4] R&TC section 41.
[5] IRC sections 162 & 262.

LEGISLATIVE HISTORY

SB 38 Lockyer (Chapter 954, Statutes of 1996) allowed a credit for transportation costs in connection with the donation of agricultural products to a nonprofit based on $.14 (fourteen cents) per mile or actual costs.

PROGRAM BACKGROUND

Refundable Tax Credits

The department's experience shows that refundable credits provide an incentive for individuals to commit refund fraud or identity theft to obtain an erroneous refund.

Examples of refund fraud and identity theft include:

- A taxpayer intentionally claiming a credit that exceeds the amount to which they are entitled;
- A tax preparer claiming a credit fraudulently without the taxpayer's knowledge;
- An individual filing a fraudulent return using fictitious information (name and social security number; and
- An identify thief filing a fraudulent return using a victim's taxpayer identification number (generally a social security number) and name (including dependent names).

The department has encountered fraud and identity theft related to Wage Withholding as discussed below:

Wage Withhold Related Fraud and Identity Theft

Employers generally withhold state income tax from employee wages, and then submit this state tax withholding to the Employment Development Department (EDD). The EDD electronically sends the FTB a list of taxpayers with the amount of state tax withheld. The department uses the EDD information to confirm state income tax withholding reported on a taxpayer’s tax return, and if amounts are incorrect, makes an adjustment to the taxpayer’s return.

For decades, the FTB has combated fraudulent attempts to receive an improper refund of state income tax withholding. Using the information received from the EDD allows the department to detect errors, including fraud, and adjust the return before the money is refunded to the taxpayer.

In the last five years, the FTB has seen a significant increase in identity theft cases, where legitimate withholding is claimed by an identity thief and discovered by the department only when the “actual” taxpayer files their tax return and claims the same withholding. In 2013, $7.5 million was improperly refunded due to identity theft.

Identity Theft

According to the U.S. Department of Justice, identity theft is the fastest growing crime in America. The Federal Trade Commission (FTC) reported an increase of over 50 percent from 2009 through 2011 in tax related identity theft complaints.[6] Unfortunately, California is a prominent participant in those statistics ranking number three in the nation for identity theft complaints.

The IRS continues to increase its efforts against refund fraud, including those resulting from identity theft. The IRS estimates that it prevented $24.2 billion in fraudulent identity theft, but paid $5.8 billion later determined to be fraudulent.[7]

IRS experience also shows that refundable credits provide an incentive for individuals to commit refund fraud or identity theft to obtain an erroneous refund as discussed below.

Federal Refundable Earned Income Tax Credit (EITC)

The IRS has historically experienced a high rate of improper payments with refundable credits. The improper payments can stem from honest mistakes; however many are related to fraud and identity theft. A significant portion is from misreporting self-employment income.

For example, for tax year 2012, the IRS estimated that it paid $63 billion in refundable EITCs and an estimated 24 percent of all EITC payments made in Fiscal Year 2013, or $14.5 billion, were paid in error.[8] Recently, the Governmental Accountability Office (GAO) has reported that for Fiscal Year 2014, the EITC error rate has increased to 27 percent.[9]

The federal EITC program has been declared a high-risk program by the Office of Management and Budget (OMB). According to the Treasury Inspector General, despite IRS education and outreach efforts, enforcement actions, and the paid tax return preparer compliance initiative, the estimated EITC improper payment rate has remained “relatively unchanged,” and the dollar amount of EITC claims paid in error has grown between fiscal year 2003 and fiscal year 2013.[10]

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[6] FTC report titled *Consumer Sentinel Network Data Book for January – December 2011*.
[7] U.S. Government Accountability Report 15-119 *Identity Theft and Tax Fraud*. http://www.gao.gov/assets/670/667964.pdf.
[8] Treasury Inspector General (TIG) Report *Existing Compliance Processes Will Not Reduce the Billions of Dollars in Improper Earned Income Tax Credit and Additional Child Tax Credit Payments*, dated September 29, 2014.
[9] U.S. GAO Report 15-482T Improper Payments. http://www.gao.gov/assets/670/669026.pdf.
[10] TIG Report *Existing Compliance Processes Will Not Reduce the Billions of Dollars in Improper Earned Income Tax Credit and Additional Child Tax Credit Payments*, dated September 29, 2014. Reference Number 2014-4-093. Fiscal Year 2003 improper EITC payments totaled from $9.5 billion to $11.5 billion as compared to Fiscal Year 2013 improper EITC payments estimated at $14.5 billion. http://www.treasury.gov/tigta/auditreports/2014reports/201440093fr.pdf.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit proposed by this bill. The laws of 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. Because this bill would create a refundable credit, the costs are anticipated to be significant.

ECONOMIC IMPACT

Because the bill has unresolved implementation concerns and fails to specify the amount per mile the credit would be based on, the FTB is unable to complete a revenue estimate.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may say that providing tax relief for the high cost of commuting would benefit working families.

Opponents: Some may argue that providing a tax incentive for commuting would be contrary to other state programs that encourage ride-sharing, use of clean-air vehicles, and alternative transportation.

POLICY CONCERNS

The department is concerned that a refundable credit could exacerbate the trend in refund fraud and identity theft. Historically, both the IRS and the FTB have experienced fraud with refundable credits. These concerns are heightened because if a refund is determined to be fraudulent; the refund commonly cannot be recovered. Striking the refund provision from this credit would substantially reduce the department's concerns about fraud.

This bill could allow taxpayers in certain circumstances to claim multiple tax benefits for the same commuting miles. For example, this bill would allow a credit based on miles that could also be currently deductible as an employee business expense. 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 lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

This bill would allow 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.

The credit would be allowed for commuting miles occurring both inside and outside of California.

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