Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Galgiani, et al.	Analyst:	Diane Deatherage	Bill Number:	SB 710
Related Bills:	See Legislative History	Telephone:	845-4783	Amended Dates:	May 12, 19, & 28, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Interest Earned on Bonds, Out-of-State Projects that is not Exempt from Tax

SUMMARY

This bill would modify the Government Code relating to taxation of bond interest.

This analysis only addresses the provisions of this bill that impact the department's programs and operations.

RECOMMENDATION

No position.

Summary of Amendments

The May 12, 2015, amendments modified existing provisions of the Government Code relating to revenue bonds.

The May 19, 2015, amendments added provisions to the bill relating to bond issuance and taxation of bond interest.

The May 28, 2015, amendments modified provisions in the bill as 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 ensure that California remains competitive with other states that already have the authority to finance multi-state projects.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective and operative immediately upon enactment.

PROGRAM BACKGROUND

Joint powers are exercised when the public officials of two or more agencies agree to create another legal entity or establish a joint approach to work on a common problem, fund a project, or act as a representative body for a specific activity.

Board Position:						Executive Officer	Date
	S		NA	X	NP	Selvi Stanislaus	6/18/15
	SA		O		NAR		
	N		OUA				

In 1949, the Legislature gave Joint Power Authorities (JPAs) the ability to incur debt and sell bonds to construct public-use buildings, such as exhibition centers, sports coliseums, and associated parking facilities.[1] In 2000, the Legislature formally named the law the Joint Exercise of Powers Act.[2]

The Joint Exercise of Powers Act allows two or more public agencies to exercise their common powers by signing joint powers agreements.

After California's voters passed Proposition 13 in 1978, local governments saw property tax revenues shrink at the same time their population growth boosted demands for facilities and services. Counties, cities, and special districts had trouble financing courtrooms, city halls, jails, and other public facilities. The Legislature responded by passing the Marks-Roos Local Bond Pooling Act, allowing local agencies to form JPAs that can sell one large bond and then loan the money to local agencies.[3] This practice, known as bond pooling, saves money on interest rates and finance charges and allows smaller local agencies to enter the bond market.

A JPA can issue tax-exempt revenue bonds to finance projects that provide a public benefit and are located within the geographic boundaries of its member agencies. State law requires local approval of the construction, acquisition, and financing of public benefit projects. The local agency with approval power must be the city, county, or city and county within whose boundaries the public benefit project is to be located; the law also specifies that the local agency with approval power must have land use jurisdiction over the project.[4]

Certain types of non-governmental borrowers can take advantage of tax-exempt financing through "conduit revenue bonds," which are issued by many types of governmental agencies, including state financing authorities, chartered cities, counties, JPAs, redevelopment agencies, and local housing and industrial development authorities. These bonds may be issued for various purposes, including economic development, educational and health facilities, and multi-family housing. The issuing agency loans the funds obtained from the financing to a non-governmental borrower who builds and operates the project. A conduit revenue bond is payable solely from the loan payments received from the non-governmental party, so the governmental issuer normally has no liability for debt service on the bonds. A private firm may only use a governmental agency's authority to issue tax-exempt debt if a public benefit will be provided by the project that is financed.

---

[1] SB 768 (Cunningham, 1949/1950).
[2] SB 1350 (Senate Local Government Committee, 1999/2000).
[3] SB 17 (Marks, 1985/1986).
[4] SB 147 (Kopp, 1997/1998) and AB 457 (Canciamilla, 2001/2002).

FEDERAL/STATE LAW

The California Constitution provides an exemption from income taxation for all interest from bonds issued by this state or a local government of this state. Federal law, other than the Internal Revenue Code, prohibits state taxation of interest on federal bonds if the interest on state obligations is exempt from tax.

Taxpayers subject to the corporate franchise tax must include in the measure of franchise tax all interest received, including interest on state and federal governmental obligations that is exempt from income tax. Interest received from direct federal obligations and California obligations or its political subdivisions is excluded from income subject to the corporation income tax and personal income tax.

Interest on bonds issued by other states or local governments located in other states is subject to tax under California law.

THIS BILL

This bill would allow a JPA, until January 1, 2022, to issue bonds and enter into a loan agreement to finance or refinance a project that is situated in another state, including working capital related to that project, if all of the following apply:

- The project is owned, developed, or operated by a private entity.
- The city, county, or other public body with land use planning authority over the project, or the state in which the project is situated, approves, by resolution, order, or other official action, the authority's bond issuance and the project's financing. This approval requirement does not apply to the issuance of refunding bonds if the city, county, public body, or state approved a prior financing or refinancing of the project.
- The authority has at least 25 local agency members and the authority has issued bonds and entered into loan agreements to finance at least 25 separate projects.
- The authority finds, based on the facts and circumstances attendant to the project or the financing or refinancing of the project, that the issuance of the bonds or the financing or refinancing of the project will result in a substantial public benefit to California because one or more of the following is satisfied:
    - At least 20 percent of the net proceeds of the issue are allocated to the financing of one or more projects, including related working capital, located in California.
    - The borrower of the proceeds has its principal place of business in California and, if that borrower is subject to income or franchise tax in California or any other state, that borrower has paid to California for the most recent tax year income or franchise tax of at least $50,000, or half of its total income or franchise tax liability to all states, whichever is less. If the borrower has little or no assets other than the project to be financed and is owned by another company or companies, then the company or companies that own a majority of interest in the borrower must have its or their principal place of business in California.

- The borrower of the bond proceeds or a controlled group of which it is a member has at least 50 full-time equivalent employees in this state.
- The borrower of the bond proceeds or a controlled group of which it is a member has paid to California for the most recent tax year income or franchise tax of at least $100,000.
- In the case of the financing of one or more multi-family rental housing projects, the developer of the project or projects has its principal place of business in California. Any such developer subject to personal or corporate income tax in California or any other state has paid to California for the most recent tax year income or franchise tax of at least $50,000, or half of its total income or franchise tax liability to all states, whichever is less.

This bill would define the following terms: controlled group, developer, financing, issue, net proceeds of an issue, and principal place of business.

This bill would require the Legislative Analyst, on or before January 1, 2021, to prepare and submit to the Legislature a report on the issuance of bonds and the financing of projects pursuant to the bill's provisions. No later than July 1, 2020, authorities that issue bonds pursuant to the authority granted by this bill would be required to provide information concerning those bonds, the projects financed, the public benefits accruing to California and any other information requested by the Legislative Analyst's Office for the purpose of preparing the report. The report may include recommendations for modifying or extending the application of the bill's provisions.

This bill would provide that the interest on an issue of bonds would not be exempt from taxation and would be included in gross income under the Personal Income Tax Law (PITL)[5] and the Corporation Tax Law (CTL).[6]

This bill would remain in effect only until January 1, 2022, and as of that date, would be repealed.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

LEGISLATIVE HISTORY

AB 2046 (Gomez, 2013/2014) was substantially similar to SB 710. AB 2046 was held in the Senate Appropriations Committee.

SB 188 (Negrete McLeod, 2007/2008), would have allowed one California JPA, the California Statewide Communities Development authority, to issue debt for projects located outside of California. SB 188 died in the Senate Appropriations Committee.

---

[5] California Revenue and Taxation Code Part 10 – Personal Income Tax Law.
[6] California Revenue and Taxation Code Part 11 – Corporation Tax Law.

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.

Florida and *Illinois* allow public entities formed under their laws to issue conduit financing bonds for projects located outside of those states' boundaries. No laws similar to this bill's were identified for *Massachusetts, Michigan, Minnesota,* and *New York.*

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

There would be a revenue impact to the General Fund, but the amount is unknown.

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

Revenue Discussion

To determine the magnitude of the impact to the General Fund, both the frequency and amount of bonds issued by a JPA must be known. Because it is difficult to predict the frequency and value of these bonds, department staff are unable to provide an annual estimate; however, the department estimates that for every $100 million in bonds issued, there would be a revenue gain of approximately $480,000.

LEGAL IMPACT

This bill provides that the interest on bonds issued by a JPA pursuant to this bill would be taxable and included in gross income under the PITL and the CTL. However, the California Constitution, Article XIII, Section 26(b) provides that interest on bonds issued by the state or a local government is exempt from taxes on income. It is unclear whether bonds issued by a JPA would be considered obligations of the state or local government for purposes of the constitutional exemption from income tax.

SUPPORT/OPPOSITION[7]

Support: California Municipal Finance Authority, and Independent Cities Finance Authority.

Opposition: Howard Jarvis Taxpayers Association; WCA Services.

ARGUMENTS

Proponents: Some may say that allowing California JPAs to assist in financing multi-state and out-of-state projects would generate time, efficiency, and transaction cost benefits to enterprises with substantial operations, employment or headquarters in California.

Opponents: Some may argue that the criteria specified in the bill may be insufficient to ensure that bonds issued pursuant to the bill's provisions generate sufficient public benefits in California.

LEGISLATIVE STAFF CONTACT

Diane Deatherage	Jame Eiserman	Gail Hall
Legislative Analyst, FTB	Revenue Manager, FTB	Legislative Director, FTB
(916) 845-4783	(916) 845-7484	(916) 845-6333
diane.deatherage@ftb.ca.gov	jame.eiserman@ftb.ca.gov	gail.hall@ftb.ca.gov

[7] From Senate Rules Committee analysis, dated May 31, 2015.