

## SUMMARY ANALYSIS OF AMENDED BILL

Author: Baugh Analyst: Colin Stevens Bill Number: AB 2311

Related Bills: See prior analysis Telephone: 845-3036 Amended Date: 4/30/98

Attorney: Doug Bramhall

Sponsor:

**SUBJECT:** Small Business Vehicle Smog Check Station Dynamometer and Equipment Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended APRIL 2, 1998.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED APRIL 2, 1998, STILL APPLIES.

OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to the cost, less certain amounts, for the purchase or lease of a dynamometer and related equipment necessary to comply with Smog Check II regulations. A maximum \$50,000 credit would be allowed for each dynamometer to a smog check station that is a small business. This bill also would allow an additional credit for costs in excess of \$5,000 if additional enhancements are required by state regulations.

SUMMARY OF AMENDMENT

The April 30, 1998, amendments would:

- Limit the credit to small businesses as defined in federal small business size regulations;
- Remove the "depreciation adjustment" from the costs subtracted to arrive at the adjusted cost;
- Allow an additional credit for costs in excess of \$5,000 if additional equipment enhancements are required by state regulations;
- Allow a taxpayer who leases a dynamometer and related equipment to receive the credit;

DEPARTMENTS THAT MAY BE AFFECTED:

\_\_\_ STATE MANDATE

\_\_\_ GOVERNOR'S APPOINTMENT

Board Position:

\_\_\_ S            \_\_\_ O  
\_\_\_ SA        \_\_\_ OUA  
\_\_\_ N         \_\_\_ NP  
\_\_\_ NA        \_\_\_ NAR  
 PENDING

Agency Secretary Position:

\_\_\_ S            \_\_\_ O  
\_\_\_ SA        \_\_\_ OUA  
\_\_\_ N         \_\_\_ NP  
\_\_\_ NA        \_\_\_ NAR  
DEFER TO \_\_\_\_\_

**GOVERNOR'S OFFICE USE**

Position Approved    \_\_\_  
Position Disapproved \_\_\_  
Position Noted        \_\_\_

Department/Legislative Director    Date  
**Johnnie Lou Rosas**                    **5/11/98**

Agency Secretary                      Date

By:    Date:

- Add service maintenance contracts purchased but not used to the adjusted cost for which a credit may be allowed;
- Provide that a taxpayer that elects to take a credit pursuant to the bill will no longer be able to issue smog certificates; and
- Added another finding regarding smog testing that may trigger the operative date of the credit.

The changes noted above resolved some of the department's concerns and raised some new considerations noted below. The remainder of the department's analysis of the bill as amended April 2, 1998, still applies. The considerations that apply are included below.

#### Policy Considerations

This bill would allow a credit to a taxpayer who leases a dynamometer and related equipment, including a taxpayer who leases through an operating lease, which is merely a rental agreement.

This bill would not limit the credit to only the original taxpayer purchasing or leasing the equipment. Therefore, it is possible that multiple credits could be generated for multiple taxpayers from the same property.

Fundamentally this bill authorizes a credit only if a future event of uncertain likelihood occurs, i.e. a reduction in the number of vehicles required to receive a smog certificate under Smog Check II. Also, the credit is allowed only if the taxpayer no longer issues smog certificates, so this credit may only be claimed by taxpayers who go out of this business, presumably because of the reduction in the state's smog certification requirements.

Current law for S corporations provides that the corporation receives one-third of any credit normally allowable. Shareholders of the S corporation receive a credit in proportion to their share of costs paid or incurred. This bill would allow an S corporation to receive the full credit amount and would provide that shareholders would receive a pro rata share of any credit.

#### Implementation Considerations

The April 30, 1998, amendments would allow an additional credit for equipment enhancements costs of more than \$5,000 required by state regulations. This provision is unclear in the following areas:

- Although it appears that the additional credit would be equal to 100% of identified costs above \$5,000, no credit percentage is specified.
- The bill does not specify a time period within which a taxpayer would need to acquire the enhancements (within the same year, the life of the equipment, or in a single purchase).
- It is unclear whether a taxpayer would be required to spend \$5,000 in enhancements on one dynamometer, or whether a cumulative \$5,000 spent on several machines would qualify a taxpayer for this credit.

- It appears that no additional credit would be allowed if enhancements are required by statute, instead of by regulation.

It is unclear whether the author's office intends the term "service maintenance contracts purchased, but not used" to include the portion of a service maintenance contract not used or whether it is intended to include only service maintenance contracts for which no portion is used. Clarification will help to ensure that disputes do not arise between taxpayers and the department.

This bill would subtract from the amount of credit any deductions allowed for the purchase or lease of a dynamometer and equipment. However, it is unclear whether this amount would include deductions (such as depreciation deductions) allowed during a single year, those allowed up to and including the year the credit becomes operative, or the entire amount allowed during the entire life of the equipment, even if not yet claimed.

This bill would require the Air Resources Board (CARB) to notify the FTB if it makes certain findings, but does not require that findings be made by a specific date. Since tax booklets are sent for final printing by October each year, if the CARB makes a finding after that time, the FTB would not be able to include the credit on the tax forms for that year. Since a review process is required prior to printing tax forms, it would help if this bill specified that CARB provide findings to FTB no later than August 31.

This bill would not require that a taxpayer receive or retain documentation indicating that the dynamometer and related equipment comply with the relevant sections of the California Code of Regulations (CCR). Department staff may have difficulty determining whether equipment complies with the CCR. The potential for conflicts between taxpayers and department staff would be decreased if taxpayers were required to provide documentation that the dynamometers meet applicable standards.

It appears that the taxpayer should claim the credit in the year that the CARB makes the finding and the credit becomes operative, even if the dynamometer was purchased earlier. However, this language needs clarification if this is the author's intent.

This bill's provisions would become operative only if a policy, regulation, or statute is enacted by any agency of the State of California before a certain date. However, the operative date language is misleading since only the Legislature may enact statutes, and the Legislature is not an agency. Moreover, this bill would not become operative in the case of an initiative passed by a vote of the people.

This bill would allow a credit to a smog check station; most credits are allowed to a taxpayer. Amendments 2 and 6 would clarify that this credit would be allowed to a taxpayer who owns or operates a smog check station.

#### Technical Considerations

The repeal date is incorrect and may prevent taxpayers who file returns on a fiscal year basis to claim the credit in the final year. Amendments 4 and 8 would correct this problem.

The PITL and B&CTL language do not clearly limit the carryover to six years as intended. Amendments 3 and 7 would clarify that carryover would be limited to six years.

The credit should be allowed against the net tax or tax, rather than against "the amount of" net tax or tax. Amendments 1 and 5 would delete the unnecessary language.

The B&CTL language incorrectly allows a credit against the "net tax." Net tax is a term used in the PITL. The correct term is "tax" as defined in Section 23036 of the Revenue and Taxation Code. Amendment 5 would correct this reference.

#### FISCAL IMPACT

##### Tax Revenue Estimate

Based on the discussion below, the following table reflects the estimated impact of this proposal:

Estimated Revenue Impact AB 2311				
Assumes Findings Made By 4/1/99				
For Taxable or Income Years Beginning 1/1/99				
(In Millions)				
1998-9	1999-0	2000-01	2001-02	2002-03
(\$1)	(\$15)	(\$10)	(\$10)	(\$10)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

##### Tax Revenue Discussion

The revenue impact of this bill would be determined by the number of dynamometers and related equipment purchased since 1997 by small businesses, the cost of the dynamometer and related equipment, and the available tax liabilities of taxpayers claiming the credits.

For purposes of this estimate, it was assumed that CARB would make their finding on or about April 1, 1999, and that each dynamometer and related equipment purchased entitles the original and any subsequent owners to no more than \$50,000 in total credits. For example, if the original owner sells/transfers the equipment to another taxpayer, their combined credits cannot exceed \$50,000 for the same equipment.

Although this estimate assumes that CARB would make necessary findings by 1999, those findings could occur at a later time or may never occur. If the credit becomes operative in a year later than 1999, the revenue loss attributable to this credit would be less than the amount projected in this analysis since taxpayers would have taken greater depreciation deductions prior to claiming the credit, reducing the amount of allowable credit.

The estimate was developed in the following steps. First, according to the California Inspection and Maintenance Review Committee, it is estimated that approximately 3,500 shops will have purchased 4,500 units of Bar-97 equipment with approximately 20% of the units purchased prior to 1/1/98. Second, according to the same source the cost of Bar-97 equipment plus installation is estimated to be approximately \$60,000. This cost does not include interest payments on loans; it is assumed that interest for equipment loans does not qualify as an equipment cost. Third, it is assumed that approximately 80% of the shops purchasing Bar-97 equipment purchase one unit and are considered small businesses. Fourth, due to insufficient tax liabilities and the tentative minimum tax interaction, it was assumed that approximately 50% of credits generated would be used over a period of five years.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 2311  
As Amended April 30, 1998

AMENDMENT 1

On page 3, line 8, strike "amount of".

AMENDMENT 2

On page 3, line 21, after "a," insert:

taxpayer that owns or operates a

AMENDMENT 3

On page 4, strike lines 13-17 and insert:

(d) In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the succeeding six years if necessary, or until the credit is exhausted, whichever occurs first.

AMENDMENT 4

On page 4, strike lines 23-26 and insert:

(f) This section shall remain in effect only until December 1, 2005, and as of that date is repealed.

AMENDMENT 5

On page 4, strike lines 34-35 and insert:

there shall be allowed as a credit against the "tax" (as defined in Section 23036) an amount

AMENDMENT 6

On page 5, line 7, after "a," insert:

taxpayer that owns or operates a

AMENDMENT 7

Strike from page 5, lines 38 to page 6, line 2, inclusive, and insert:

(d) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the succeeding six years if necessary, or until the credit is exhausted, whichever occurs first.

AMENDMENT 8

Strike page 6, lines 12-15 and insert:

(g) This section shall remain in effect only until December 1, 2005, and as of that date is repealed.