Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Nazarian	Analyst:	Jessica Deitchman	Bill Number:	AB 428
Related Bills:	See Legislative History	Telephone:	845-6310	Introduced Date:	February 19, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Seismic Retrofit of At-Risk Property Credit

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), allow a credit for costs to seismically retrofit "at-risk" buildings.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to address the state's need to retrofit buildings for earthquake safety, and to provide additional tax incentive programs to encourage taxpayers to make these upgrades on buildings.

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, 2016, and before January 1, 2021.

FEDERAL/STATE LAW

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business.

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 federal and state laws lack a credit comparable to the one that would be created by this bill.

Board Position:						Executive Officer	Date
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THIS BILL

For taxable years beginning on or after January 1, 2016, and before January 1, 2021, this bill would allow a qualified taxpayer a credit in an amount equal to 30 percent of the qualified taxpayer's qualified costs.

The bill would define the following phrases:

- "Qualified taxpayer" means a taxpayer that is an owner of a qualified building located in this state. A taxpayer that owns a proportional share of a qualified building in this state may claim the credit allowed by this bill based on the taxpayer share of the qualified costs.
- "Qualified costs" means the costs paid or incurred by the taxpayer for the seismic retrofit construction on a qualified building, including any engineering or architectural work preceding the construction and does not include either of the following:
    - The costs paid or incurred by the qualified taxpayer for ordinary repair or replacement of existing fixtures or items on or in the qualified building or;
    - Any amount paid by the qualified taxpayer to the jurisdiction with authority for building code enforcement for issuing the certification required.
- "Qualified building" means a building that has been certified as an at-risk property by the local housing authority for the area within which the building is located.
- "At-risk property" means a building that is deemed hazardous and in danger of collapse in the event of a catastrophic earthquake, including, but not limited to, soft story buildings, concrete residential buildings, and pre-1994 concrete residential buildings.
- "Seismic retrofit construction" means changes or additions to the structure of a qualified building to mitigate seismic damage, including:
    - Anchoring the structure to the foundation
    - Bracing cripple walls
    - Bracing hot water heaters
    - Installing automatic gas shutoff valves
    - Installing earthquake-resistant bracing system for mobile homes that is certified by the California Department of Housing and Community Development

Seismic retrofit construction does not include construction preformed solely to bring a qualified building into compliance with standard local building codes.

To be eligible for the credit both of the following must apply:

- The qualified taxpayer must obtain, and retain, certification from the jurisdiction with authority for building code enforcement, upon a review of the building, that the building is an at-risk property. Upon request, the qualified taxpayer would be required to provide a copy of the certification to the Franchise Tax Board (FTB).

- The jurisdiction with authority for building code enforcement in which a qualified building is located has entered into an agreement with the state to provide certifications pursuant to this section and to not seek reimbursement from the state for any costs incurred in providing those certifications.

The qualified taxpayer may claim one-fifth of the credit amount for the taxable year in which the credit is allocated and one-fifth of the credit amount for each of the subsequent four taxable years.

The qualified costs used to calculate the credit would be reduced by any grant provided by a public entity for the seismic retrofit construction.

This bill would allow unused credits to be carried over for five years, if necessary, until exhausted.

This credit would be in lieu of any other credit or deduction that the qualified taxpayer may otherwise claim under PITL and CTL with respect to qualified costs.

This section would remain in effect only until December 1, 2021, and as of that date is repealed.

The bill states that the provisions of Section 41[1] would not apply.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concern. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

It is unclear when the credit should be allowed for the qualified expenses. Should the credit be allowed when the project starts or when it is finished? To ensure consistency with the author's intent as to when the five-year period to claim the credit should begin and end, and to eliminate disputes between taxpayers and the department, this bill should be amended to clarify when the credit would first be allowed.

The bill lacks language to clarify who would certify that an expense that is used to calculate the credit was for "seismic retrofit construction." Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. It is recommended that this bill be amended to include a certifying agency.

[1] Revenue and Taxation Code section 41 requires any bill introduced on or after January 1, 2015, that creates a new tax credit to contain language specifying goals, purposes, objectives, performance measures, and data collection and reporting requirements.

LEGISLATIVE HISTORY

AB 1510 (Nazarian, 2013/2014) would have allowed a credit substantially similar to the credit this bill would allow. AB 1510 would have allowed a credit equal to 30 percent of the qualified taxpayer's qualified costs for retrofitting at-risk property. AB 1510 failed to pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

SB 677 (McPherson, 2001/2002) would have allowed a credit equal to an unspecified percentage of the final cost of seismic retrofitting to comply with the seismic retrofit building standards for hospitals. SB 677 failed to pass out of the Senate Revenue and Taxation Committee by the constitutional deadline.

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. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 428 As Introduced February 19, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $1.4	- $5.2	- $9.0
This estimate assumes that there will be no new mandates requiring retrofitting activities anywhere in the state. The costs could increase significantly if a state-wide mandate is put in place.		

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

Revenue Discussion:

This bill would establish a credit for qualified costs incurred for seismic retrofit construction on an at-risk building. Based on discussions with industry experts and 2013 U.S. Census data on buildings in earthquake areas it is estimated that approximately 2,100 buildings would undergo retrofitting each year. Data provided by the California Seismic Safety Commission indicated the retrofitting cost is approximately $20,000 for residential housing and $100,000 for commercial buildings. This data results in an estimated $82 million dollars in retrofitting costs for 2013. The estimate was grown for inflation to $87 million in qualified expenditures for 2016. The amount of estimated qualified expenses was then reduced by the estimated amount of retrofitting grants issued annually (estimated at $10 million annually). This results in $77 million in qualified retrofitting costs incurred for 2016.

The credit is equal to 30 percent of qualified costs. This results in approximately $23 million in credit generated in 2016. The credit must be taken evenly over five years, resulting in approximately $4 million available in tax year 2016. The credit available will peak, when there is a five combined year period, in 2020 at approximately $24 million. Experience shows that 70 percent of the available credit will be used in the year the credit is generated and the remaining 30 percent of the credit will be used over the subsequent four years. This results in an estimated credit usage beginning at approximately $3 million in taxable year 2016 and peaking in 2020 at approximately $20 million. An adjustment was made to reflect the decreased depreciation deduction allowed when the credit is claimed.

The tax year estimates were converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the table above.

SUPPORT/OPPOSITION

Support: City of Los Angeles and California Apartment Association.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that the bill would encourage taxpayers to make necessary upgrades to existing buildings to make them earthquake safe, thus improving safety for all Californians.

Opponents: Some may argue that providing a tax credit limited to retrofitting buildings may be overly narrow and inadvertently exclude other safety issues in California that need attention.

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