STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Original Bill

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Subject: Development Impact Fees Credit Applied to Newly Constructed Single-Family and Multifamily Homes

Summary

This bill would, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), allow a credit to qualified taxpayers that pay development impact and connections fees applicable to newly constructed homes.

Recommendation – No position.

Reason for the Bill

The reason for the bill is to encourage developers to build more new single-family and multifamily homes in California by offering a tax credit.

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, 2020.

Program Background

In the years since the passage of Proposition 13, development fees have become an integral part of California's fiscal landscape.[1] Development fees—which cities levy to pay for services needed to build new housing or to offset the impacts of growth on the community—make up a significant portion of the cost to build new housing in California cities.

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[1] Ternercenter (http://ternercenter.berkeley.edu/uploads/Development_Fees_Report_Final_2.pdf)

California's development fees were nearly three times the national average in 2015. From 2008 to 2015, average development fees for new single-family homes in the state grew by approximately 19 percent.[2]

Federal/State Law

Existing federal and state 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 hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Neither federal nor state law allow a credit similar to the one that would be provided by this bill.

Current federal and state 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.

This Bill

This bill would, under the PITL and CTL, for taxable years beginning on or after January 1, 2020, allow a credit for the total amount paid or incurred during the taxable year by a qualified taxpayer for eligible expenses.

"Eligible expenses" means the total amount expended by the qualified taxpayer for payment of development impact fees and connection fees applied to newly constructed single-family and multifamily homes.

"Qualified taxpayer" means a homebuilder or developer engaged in the construction of new single-family and multifamily homes in the state.

This credit would be excluded from the requirements under Revenue and Taxation Code section 41 to include goals, performance measures, and data collection and reporting necessary to enable the Legislature to determine the effectiveness of the credit.

[2] PaytoPlay (https://www.novoco.com/sites/default/files/atoms/files/pay2play.pdf)

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 that may be identified.

This bill uses terms that are undefined, i.e., "development impact fees" and "connection fees." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended.

Legislative History

No similar legislation has been identified.

Other States' Information

Review of *Illinois, Florida, Massachusetts, Michigan*, *Minnesota*, and *New York* laws found no comparable tax credits. These states were selected and reviewed 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.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 264 as Introduced on January 24, 2019
Assumed Enactment after June 30, 2019

($ in Millions)

Fiscal Year	**Revenue**
2019-2020	- $2,700
2020-2021	-$2,700
2021-2022	-$3,000

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

Based on building permit data from the Unites States Census Bureau, there would be approximately 80,000 California construction permits issued for new single-family homes, and 76,000 issued for multifamily homes in 2020.

Based on construction industry and National Impact Fee Survey data, development impact fees are assessed and paid at the time construction permits are issued. It is estimated that the average California development impact fee would be $33,500 for a single-family home and, $22,000 for a multifamily home, totaling $4.3 billion in credit generated in taxable year 2020. It is estimated that 90 percent, or $3.9 billion, of the credit would be generated by corporations, and the remaining 10 percent, or $500 million, would be generated by personal income taxpayers in taxable year 2020.

Based on Franchise Tax Board data, it is estimated that 70 percent of the taxpayers, or $3 billion, would have a tax liability to offset with the credit, after the S corporation adjustment. Of those with a tax liability it is estimated that, 60 percent of the credit, or $1.8 billion, would be used in the year generated. The remaining $1.2 billion in credit generated would go unused. The estimate assumes that housing starts will continue to grow and as a result, it is estimated that by taxable year 2025 the amount of credit claimed would reach $3 billion.

The tax-year estimates are then converted to fiscal years and rounded to arrive at the amounts in the above table.

Policy Concerns

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 a credit for development impact fees and connection fees that are currently deductible as business expenses. 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 fails to limit the amount of the credit that may be taken. Credits that could potentially be quite costly are sometimes limited either on a per-project or per-taxpayer basis. This bill would provide a 100 percent credit which would be unprecedented.

This bill lacks carryover language. As a result, any unused credit would be lost if the taxpayer is unable to use the entire credit amount in the year claimed. The author may wish to add language allowing a limited carryover period.

The credit would be allowed for development impact fees and connection fees paid or incurred either inside or outside California.

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