



## **Summary Analysis of Amended Bill**

Author: Rubio

Sponsor:

Bill Number: SB 775

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Amended: May 7, 2019

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Related Bills: See Prior Analysis

**Subject:** Exempt Organizations/Mutual Ditch or Irrigation Companies

### **Summary**

Under the Corporation Tax Law, this bill would exempt certain mutual ditch or irrigation companies from tax.

**Recommendation – No position.**

### **Summary of Amendments**

The May 7, 2019, amendments added water health and safety criteria and local agency formation commission (LAFC) informational requirements for mutual ditch or irrigation companies that operate a public water system to qualify for tax exemption; regardless of tax exemption qualification, added an exclusion from gross income for funding received from the State Water Resources Control Board; and made several minor technical corrections.

The May 7, 2019, amendments resolved the previously identified technical consideration, and an implementation consideration was identified. Except for "This Bill," "Implementation Considerations," "Technical Considerations," "Economic Impact," and "Policy Concerns" sections, the remainder of the department's analysis of the bill as introduced February 22, 2019, still applies. The "Fiscal Impact" section has been restated for convenience.

### **Reason for the Bill**

The reason for this bill is to conform to federal law that allows certain mutual ditch and irrigation companies to be treated as tax-exempt organizations.

### **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, 2019.

## **This Bill**

For taxable years beginning on or after January 1, 2019, this bill would generally exempt mutual ditch and irrigation companies that operate a public water system from corporate income and franchise taxes, unless the ditch and irrigation company (company) fails to meet requirements as specified in either or both the Corporations Code and the Health and Safety Code, or fails to provide information to a LAFC.

A company that fails to meet any or all of the requirements specified would be allowed to exclude from gross income any funding received from the State Water Resources Control Board, and such funding would have no impact on the company's tax-exempt status.

## **Implementation Considerations**

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

This bill would require the company to satisfy certain requirements as specified in either or both the Corporations Code and the Health and Safety Code to qualify for exemption. It is unclear how the department would determine if a company satisfies the criteria necessary to qualify for this tax exemption. For clarity and ease of administration, it is recommended that the bill be amended.

This bill would also require a company to provide information to LAFCs upon request. How would the Franchise Tax Board (FTB) know that a failure had occurred? For purposes of administration, it is recommended that the author amend the bill to require when a company does not comply with a LAFC's request, that the LAFC report the failure to the FTB.

This bill lacks administrative details necessary to implement the bill. The bill is silent on the impact of a company that fails to meet all of the requirements, would that trigger taxability of all income except for amounts received from the State Water Resources Control Board? For how long, just the taxable year during which the failure occurred or longer? Until corrected, or in perpetuity? To reflect the author's intentions, the bill should be amended.

## **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 SB 775 as Amended May 7, 2019  
Assumed Enactment after June 30, 2019

Fiscal Year	Revenue
2019-2020	-\$800,000
2020-2021	-\$700,000
2021-2022	-\$700,000

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 Internal Revenue Service and FTB exempt organization data, it was estimated that in 2019 companies would owe approximately \$700,000 in taxes to California. It is assumed that all companies would meet the requirements specified in the bill. As a result, the revenue loss would be \$700,000 in the 2019 taxable year.

The tax year estimates are converted to fiscal years, then rounded to arrive at the figures in the above table.

## Policy Concerns

By exempting certain types of mutual ditch and irrigation companies, and excluding certain state funding from their gross income, other entities exempted by Internal Revenue Code section 501(c)(12), such as mutual or cooperative telephone companies, or benevolent life insurance associations, may also seek to be added to the exemption or seek income exclusions.

## Legislative Staff Contact

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